PROBLEMS IN CORPORATION FINANCE

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PREFACE

This book brings together brief parts of the financial experience of a number of companies to be used as "cases" or "problems" for a course in corporation finance. The problems have been selected and grouped primarily with a view to the systematic development of the subject. It will be noted that the cases deal with the financial problems of companies operating under widely different conditions. This variety in the material provides a basis for studying financial policies as affected by such factors as the size of the company, its competitive position, the nature of the industry, and the phases of the business cycle.

The majority of the problems have been prepared after conference with the business men immediately concerned; in these the issue is usually sharply focused and the student is asked to prepare and defend a solution. This type of case has the merit of placing the student in the business setting of an actual problem. He is forced to deal with the particular before any step toward a generalization is made. To a considerable extent, however, the writer of a case does for the student what the business man must do for himself. The problems arising in the conduct of business do not appear in written form. The executive may have much or little information at his command. In any event he must prepare his own "case"; he must first recognize the problem, define it precisely, and then search out and weigh the relevant facts that are necessary for its solution.

In the belief that there is also valuable training in the sorting and analysis of the financial data made available by current publications, a number of the cases have been assembled largely from the material found in financial manuals and periodicals. These manuals and the annual reports of companies are still the most common sources of ready information on financial affairs. Such sources frequently fail to give important facts and do not present the many intangible factors and personal elements which so frequently dominate a business situation. This lack of detail in the published data is a challenge to those with intellectual curiosity to find reasonable explanations for the apparent policy of a com-

pany. Furthermore, if students are to look at financial problems from the managerial point of view it is quite as helpful for them to determine what facts are necessary in order to view a situation in true perspective as to analyze the situation when ample data are available. From a study of such material the student gradually acquires a knowledge of financial practices. Of equal importance is the fact that by continual observation and interpretation of changes in the reported data he develops ability to appraise the financial condition and prospects of a business.

When viewed in perspective the cases in this book reveal certain new trends in the practice of corporation finance. In many instances, for example, corporations have made drastic reductions in the par or stated value of their capital stock. Working capital frequently has been maintained, in spite of operating losses, by the process of conversion of fixed assets into current assets. Corporations strong in cash position have used funds to retire not only their fixed charge obligations but also portions of their outstanding capital stock. Only a superficial observer would regard these practices merely as the adaptation of accounting technique to temporary situations. For the student of finance they raise significant and challenging queries.

Despite the enactment of legislation which has imposed new methods upon financial management, the fundamentals of business finance remain essentially unchanged. Unless our economic system develops largely into one of socialized capitalism with the raising and disposition of funds almost wholly under some sort of governmental control, private corporations will continue to be formed to carry out the plans of promoters, companies will be faced with the necessity of raising capital, decisions will be required as to the disposition of income, and mergers will be consummated. Unfortunately, as long as fallible human judgment directs the allocation of capital, the difficult problems involved in effecting financial reorganizations and readjustments will probably remain to perplex corporate managements. In short, the collection and utilization of funds in a manner which will preserve for business units a well-balanced and adequate financial structure will continue to raise significant questions for the student of corporation finance.

As a result of the large amount of systematic study that has been given to the financial aspects of business, there is available a substantial body of financial literature. This offers opportunity

for the student to supplement his own analysis of specific business problems, and to broaden his background in the general field. For these purposes, lists of selected references in corporation finance have been drawn up: a general list dealing with the broader implications of the subject, and topical references which bear more directly on the specific issues raised by each group of problems. While not exhaustive, the lists furnish considerable scope for assignments of collateral reading.

In the collection of the material for most of the cases, we have had the assistance of Mr. Albert O. Greef, Instructor in Finance, Mr. Dickson H. Leavens, and Mr. Bay E. Estes, Jr. Mr. John C. Baker, Instructor in Finance, has suggested some especially interesting situations. We also have had the helpful criticism of Professor Deane W. Malott who, with the authors, has taught many of the cases included in this book. The tedious and important work of editing the manuscript in all its stages has been shared by Mrs. Elizabeth L. Dalton and Mrs. Shirley G. Carlson, with the assistance of Miss Rachel D. Crosby.

A few cases have been reprinted from the second edition of Fraser's *Problems in Finance*; these and many of the others present problems arising prior to 1930. Most of the cases, however, have their setting in the last three or four years. Taken as a whole, the material gives the student an opportunity to draw significant comparisons between the financial problems of a depression and those of a period when the recurrence of depression was little considered.

R. L. MASSON.
S. S. STRATTON.

SOLDIERS FIELD,
BOSTON, MASSACHUSETTS,
JANUARY, 1935.

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[1] For the most part fictitious names have been used and other methods have been taken to disguise actual companies. Wherever the real name of a company has been used, the facts and financial data in the case have been taken from published sources.

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ALPHABETICAL LIST OF PROBLEMS

I

PROMOTION

1. WEST COAST TRADING CORPORATION

PROMOTION OF CANNING COMPANY

In September, 1932, Mr. George Malcolm and a group of associates were considering the organization of a company, to be known as the West Coast Trading Corporation, for canning tomato products in Mexico and also for importing from that country a variety of fresh vegetables, such as tomatoes, beans, peas, and peppers, for sale in American markets.

Mr. Malcolm, who was then thirty-five years old, was an automobile salesman in New York City. Early in August, 1932, while spending his vacation in California, he had met an old friend, Robert Norris, who for several years had been the superintendent of a large sugar refinery near Los Mochis in the state of Sinaloa on the west coast of Mexico. From Mr. Norris he learned that the west coast of Mexico possessed unusual advantages in favorable climate, fertile soil, cheap labor, and access to cheap transportation facilities, for the production and shipment to the United States during the winter months of a wide variety of fresh vegetables. When he found out that only one-fifth of the tomatoes grown in Sinaloa were exported, and that during the season of 1931–1932 a surplus of some 300,000,000 lb. of high-grade tomatoes produced in this region had been destroyed or left in the fields, he conceived the idea of forming a company of the type mentioned above. After discussing the plan at some length, both he and Mr. Norris concluded that it could be carried out successfully if the necessary capital could be raised. They decided, however, that it would be advisable to make a careful preliminary investigation to determine whether the profits that might reasonably be expected would be sufficient to justify organizing a company. They agreed, therefore, that each should subscribe $200 to a fund of $2,000 to be used for defraying the expenses of the preliminary investigation, and that Mr. Malcolm should endeavor to raise the remaining $1,600 in New York.

Early in September, shortly after his return to New York, Mr. Malcolm succeeded in inducing eight of his friends to contribute the remaining $1,600 required. Mr. Norris then proceeded with the preliminary investigation.

After visiting a number of canning plants in the United States, consulting with railway and steamship company officials in California and Mexico, and interviewing a number of large producers of tomatoes and other vegetables in Sinaloa, Mr. Norris, toward the close of September, submitted a report to Mr. Malcolm and his associates. Excerpts from this report follow:

From January to April the production of tomatoes in the United States is so small as to be of no consequence. In Mexico, on the other hand, production during the same period is enormous. In fact, tomatoes may then be purchased in the latter country for the mere cost of gathering them.

On the west coast of Mexico, tomatoes are grown mainly in the state of Sinaloa. But production in southern Sonora, the state immediately north of Sinaloa, is increasing rapidly, partly because the vines there begin to produce about 30 days earlier than those farther south. Tomatoes grown in these regions are known in practically every market in the United States. During the winter months, about 100 carloads of these tomatoes are shipped to this country and Canada every day. Carload shipments through Nozales, Arizona, alone during the last five seasons have been estimated as follows: 1927–1928, 3,883; 1928–1929, 3,898; 1929–1930, 5,579; 1930–1931, 4,192; 1931–1932, 4,467.

Mexican tomatoes, as has been shown by tests conducted by leading American packers, compare favorably as to quality, color, and flavor with any grown in the United States.

While numerous other vegetables of a high quality can be produced at low cost on the west coast of Mexico and sold in American markets, it would seem advisable for the proposed company to confine its operations at the start to canning tomato juice, pulp, and purée (used for making soup, ketchup, tomato paste, and chili sauce).

The most favorable location for a canning plant would seem to be in San Blas or Los Mochis, Sinaloa, near the main line of the Southern Pacific Railroad of Mexico or the Kansas City, Mexico, and Orient Railway Company. Both these localities, which are about 500 miles south of Nogales, Arizona, offer the advantages of satisfactory transportation facilities, plenty of skilled and unskilled labor, and sufficient water for all plant purposes. It is probably safe to say that labor, taxes, and general operating conditions are as satisfactory in these regions as anywhere in the United States.

It is recommended that canned tomato juice, pulp, and purée be sold in the beginning only to the large packers and the wholesale trade. Both these classes of dealers presumably would sell these products, with or without further processing, in their own containers and under

their own labels. They should be willing to pay about 40 cents a gallon for such products; and since our total cost of production and selling to Eastern markets, as shown in Exhibit 1 enclosed, has been estimated at 30 cents a gallon, our proposed company should be able to sell its output at a profit of about 10 cents a gallon.

Later on, we could sell these products under our own labels to retail dealers in Oklahoma, Texas, New Mexico, and Arizona, as well as in Mexico itself. Because of the shorter freight haul, we should be able to realize attractive profits on sales to these markets.

The costs shown in Exhibit 1 have probably been overestimated. As a matter of fact, the Republic of Mexico would probably exempt our company from taxes for a period of 10 years. Moreover, ranchers in the Los Mochis district said they would be willing to give us free for

EXHIBIT 1
WEST COAST TRADING CORPORATION
ESTIMATED COSTS OF PRODUCTION AND DISTRIBUTION OF TOMATO JUICE AND PULP*

Plant costs:		
Building, 50 by 100 ft.	$ 5,000	
Diesel engine, 50 hp	5,000	
Boiler, 100 hp	5,000	
Cost of equipment installed	12,500	
Water well, casting, and pump	3,000	
Lease for plant	1,000	
Railroad switch to plant	1,000	
Total cost of plant ready for operation	$32,500	
Daily operating costs:		
Interest on money invested	$	27.39
Fuel oil		22.50
Employees		
4 experts		30.00
14 men		45.00
62 women		45.00
Depreciation—plant		17.26
Taxes		5.00
40 tons tomatoes, at $5 a ton delivered		200 00
Cans, 7,200 gal. at $8 a hundred		576.00
Freight		900.00
Tariff duties		210.00
Total	$	2,078.15
Cost per gallon laid down in New York		0.29
Selling cost in East (5% of manufacturing cost)		103.90
Total cost, including selling	$	2,182 05 (30 cents a gallon)

* These costs estimated on assumption that plant has capacity for producing 10 gal. a minute for 12 hr. a day, or a total daily capacity of 7,200 gal.

Net profit should be at least 10 cents a gallon, or $720 for each working day. Total yearly net profit, on assumption that plant operates 150 days each year, should be $108,000.

the first year undersized and oversized tomatoes, which make up about 75% of their crop but cannot be shipped to graded markets; and a leading sugar company stated we could make our own conditions as far as concerns the use of their railroad, land for a plant site, electricity, ice, etc.

1. Should the proposed company have been organized?

2. Approximately how much capital should have been raised for such a company?

3. How should the necessary capital have been obtained?

2. BORDEN & CAMPBELL

PROMOTION OF SPECIAL-ALLOY METAL COMPANY

In the autumn of 1932 the Chicago investment firm of Borden & Campbell was approached by Henry Nolan for advice and assistance in raising capital for the Nolan Manufacturing Corporation. This corporation had been organized by Nolan in November, 1931, to carry on the manufacture of cooking utensils and other articles from an alloy which Nolan had discovered, and which he claimed was superior to other metals for such uses. The corporation had an authorized capital of 10,000 shares of no par value. Nolan had succeeded in interesting two friends who put up $1,000 each, and a third who put up $500. In return they took stock at $5 per share, and Nolan appropriated an equal number of shares as representing his compensation for the use of his formula and knowledge, although the company was not to own the formula. The sum of $2,400 was applied as a down payment on secondhand machinery valued at $10,000 to $12,000 but secured for $5,000; the remainder was to be paid on delivery.

Nolan had been unable to obtain any further investment in his company, and at the end of August, 1932, its balance sheet was as follows:

Assets	
Machinery, not yet delivered	$5,000
Organization expenses	100
Goodwill	2,500
	$7,600
Liabilities	
Due on machinery	$2,600
Capital stock:	
Authorized: 10,000 shares, no par value	
Issued: 1,000 shares	5,000
	$7,600

Since no actual production could be started without more capital to finance delivery of the machinery and other expenses, Nolan asked Borden & Campbell whether they could assist in raising funds.

Although Borden & Campbell were primarily engaged in the sale of securities originated by others, they had a certain number

of clients who were interested in sharing in an occasional speculative investment which showed promise of good profit. In order to meet their needs, the firm welcomed proposals such as that of Nolan and had on its staff an engineer, Mr. Merrick, who made a thorough investigation of each project. In many cases weak points appeared at the start and the project was turned down without further study; but in a few instances, where the prospects were favorable enough to induce the firm to arrange financing, the results had been very profitable for all concerned. Accordingly, on the chance that Mr. Nolan's plan might turn out to be good, Mr. Merrick was assigned to study it. Extracts from his report of December 2, 1932, follow:

Introduction.—Mr. Henry Nolan is an engineer and mechanic, about forty-five years old. He has been a foreman and plant superintendent in two large companies manufacturing alloys and while working in one of them accidentally discovered a new alloy, in the "stainless" class, which appears to be suitable for the manufacture of cooking utensils, marine hardware, decorative trim, plumbing fixtures, novelties, etc. He has not yet secured patents but has had a patent search made, and it is believed that good patents can be obtained.

Composition of Metal.—Mr. Nolan did not reveal the composition of the metal, but apparently it contains nickel and chromium among other components. It is stated definitely that it has no iron and no aluminum, unless as impurities. Ten samples from the same piece were analyzed by the Bureau of Standards, which reported different results for the different pieces, not only as to proportions, but also as to component metals.

Properties of Metal.—It melts at 2650° to 3000°F., and is easy to cast. It can be hardened by packing. When hard, it is difficult to machine but can be machined soft and then hardened. It can be rolled into sheets and stamped similarly to aluminum or tin plate.

Cost of Metal.—With nickel at 30 cents, chromium at 8 to 13 cents, and two other components at $1.98 and $2 per pound, respectively, Nolan estimates the following costs for three varieties of his metal:

No. 1 Metal: Cast hard. Can be machined only by grinding and polishing.

	Cents per Pound
Alloys	20
Fusing	2
Ingot cost	22
Molding cost	5
Cost of castings	27

No. 2 Metal: Manufactured for use in rolling sheets; neither hard nor soft, but tough. This grade would be used for utensils, which would then be hardened.

	Cents per Pound
Alloys	26
Fusing	2
Rolling to 1/16 in.	5
	33
Rolling under 1/16 in., extra	5
	38

No. 3 Metal: Cast soft, for machining.

	Cents per Pound
Alloys	28
Fusing	2
Molding	5
Cost of castings	35

History of Company and Proposed Plan.—In November, 1931, Nolan formed the Nolan Manufacturing Corporation but after selling a little stock was not able to raise any more capital. The money raised was applied to the purchase of machinery, valued at $10,000 or $12,000; $2,600 more must be paid before this machinery can be delivered. Neither the company nor the few holders of stock have any right or title to Nolan's process or ideas.

It is, therefore, proposed to form a new company for the manufacture of the metal and of products made from it. Nolan has no capital but would contribute his process, his knowledge and services (at nominal salary), and the machinery mentioned (requiring but $2,600 more), and it is presumed that he should receive around a 50% interest.

An estimate is attached [see Exhibit 1, pages 10–11; Exhibit 2, page 12; and Exhibit 3, pages 14–15] indicating that it should not cost over $25,000 to equip a plant to produce, say, 10,000 kitchen utensils (bowls, pans, etc.) per month, and to carry it through three months of production and marketing. Sales of such a production indicate a net annual profit of over $25,000 per year. While the plan is to develop sales of kitchen utensils, it is realized that time is required to build up such a volume of sales, and it is planned to develop novelties (trays, candlesticks, etc.) for sale to chain stores, which, while they bring a limited profit, are excellent "pot boilers" to carry the operating expense of a plant.

Nolan Sales Plan.—He has a plan for selling kitchen utensils from house to house, through distributors or territory managers and salesmen. Sales from factory to distributors would be outright sales for cash, and Nolan has in the past year had various people sufficiently

sold on the proposition to agree to handle it and put up the cash. Nolan would manufacture a line of pressed or thinner utensils for house-to-house sales, and a heavier line of cast utensils for department stores (but not chain stores or mail-order houses who sell on price rather than quality).

He would sell sheet metal to anyone, except for use in utensils. He could sell ingot at about 50 cents per pound (cost about 28 cents per pound); or he could sell scrap metal (remnants from utensils) at perhaps 25 to 30 cents a pound; or he could disclose the formula and take a royalty for its use.

Proposed Factory.—There is available in Evanston a wooden factory formerly used for the manufacture of machinery. It is two blocks from the center of town on the main highway; it has an acre or so of land; backs on railroad tracks; and has a garage, a blacksmith shop, and a large storage shed. The main building has four floors and is strongly built and in excellent condition. It has good boilers and radiation and is equipped with a sprinkler system. It has two large freight elevators and has a great supply of work benches and of storage racks and bins. In short, it appears to be an ideal place for the casting and fabrication of metal articles. For the present purposes of this company, the first two floors would give ample room for the foundry and all other requirements; excellent offices already exist. The foregoing facts have been verified by a personal visit.

The owner of this property states that he is willing to rent it at a figure which will cover his carrying charges, which are as follows:

Taxes	$1,321.91	per year
Insurance	315.00	(heavy because vacant)
Water tax	12.00	
Mortgage interest	1,320.00	
	$2,968.91	= $250 per month

Mortgaged for $22,000. Can rent for $250 per month with option to buy for $30,000. It is probable that it could be bought for $25,000 cash.

Nolan has just found a concern in Cicero which manufactures small metal bathroom fixtures (soap dishes, towel racks, etc.) from sheet iron, chrome-plated. Their lease soon runs out and they must move and are willing to come to this Evanston factory and sublet the top floor at $100 per month. This concern would install chrome-plating equipment and allow Nolan to use it. Nolan would make dies for them and also do stamping for them, which would help. They would soon switch over to Nolan metal; the man owning this concern is primarily a salesman and has excellent contacts with chain and other stores. The idea is that Nolan would finally take over his manufacturing and he would sell for himself and also for Nolan. This cooperation (not combination) of the two firms should save some overhead for both.

In this connection it should be understood that Nolan does not plan to confine himself to the manufacture of kitchen utensils, as there are many other lines to which his metal is applicable, such as novelties, ash trays, decorative lamps, water faucets, drain boards, vases, etc.,

as well as for the sale of the metal in sheets and the production of castings for other manufacturers.

Opinion of the Metal.—I have seen the metal melted, cast, and machined and have made many tests of its physical qualities and its resistance to corrosion, and I have compared it with the products with which it would compete and I consider that it is a most superior product. Its value, commercially, of course, depends on its cost and on its superiority or its advantages over competing metals; briefly, I believe that while this alloy would not be so cheap as aluminum it should undersell stainless steel, chrome-plated ware, and similar corrosion-resisting metals. It can be easily cast, machined, rolled, pressed, and formed, and, unlike most metals, it can then be hardened to an extreme degree. When completed, therefore, it has a very hard, brilliant, and attractive finish, is remarkably resistant to corrosion, staining, scratching, and other abuse, and is consequently very easy to keep clean. I consider it far superior to aluminum and all the other competing metals.

Opinion of Nolan and the Project in General.—Mr. Nolan personally has an excellent record and experience in the manufacture of metals and metal products and impresses me most favorably. He should be a most important factor in the success of this project, as he is a skilled mechanic, has been long in charge of precisely similar operations, and is capable personally of handling every step of the manufacture. He is not grasping and is willing to work hard personally, to make sacrifices to get his idea into operation, and to work along with it for nominal compensation at the start.

I personally think enough of the project to be willing to devote a lot of time and effort to it on the chance of compensation from its future profits. This project is not so large as some others under consideration, but it is clean, involves comparatively small expense, has no handicaps, and has a lot of favorable features, with prospects of an excellent profit to be made.

General Conclusions.—It will, of course, take time to build up sales of 10,000 pieces per month, but such a volume is exceeded many times by many of the manufacturers of aluminum utensils. The margin of profit shown is very large, and yet the retail prices resulting, although higher than for aluminum utensils, are lower than the prices on the good grades of competing wares—chrome-plated ware, cast iron, chrome-plated copper, etc. It is also my belief that a most substantial volume of sales may be quickly obtained in the manufacture of small novelties for the chain stores. It should also be noted that there is a good market for small castings of the metal to local manufacturers of marine hardware, chemical-handling machinery, etc. Some of these manufacturers have already been contacted and are definitely interested.

With the growth and expansion of the company, there is a far wider market for its products in the manufacture of parts and trim for washing machines, ranges, bakery and dairy machinery, plumbing supplies, ornamental trim, or in the sale of ingots or sheets to the manufacturers of such items, and it will also be possible to lease the process

on a royalty basis. Any such expansion would require an increase in capitalization and need not be considered in the original set-up.

The foregoing is given as only a summary of the project, and more detail is available. It should be said that I have personally investigated the project for several months and have verified practically all the statements and claims made, to a point where I am satisfied that the project is worthy of an investment in the manner suggested.

The foregoing matter has only touched upon the excellent markets available for the sale of novelties, a matter which we have gone into quite thoroughly. Since a large chain has changed its policy to permit the sale of 20-cent articles, it has been handling quite a variety of trays, dishes, vases, candlesticks, etc., made of pewter and other metals, and selling at 20 cents. These items are bought for 12 cents each, as a rule, and on most of them we could make a profit of at least

EXHIBIT 1
NOLAN MANUFACTURING CORPORATION
ESTIMATE OF FINANCIAL REQUIREMENTS

Preliminary costs:		
Balance due on Nolan's machinery at Indianapolis	$2,600	
Move and install this machinery	1,500	
Buy and install rolling mill (used)	1,000	
Bakelite press, for handles	500	
Build 3 furnaces (2 melt, 1 for heat treatment)	300	
Crucibles, etc.	500	
Oil tank for fuel oil	50	
Miscellaneous foundry supplies	50	
Dies, patterns, molds for 12 pieces pressed and 12 cast	2,000	
3 tumbling barrels	100	
Polishing and buffing wheels	300	
Spot welder	1,000	
Motors: one 25 hp., two 10 hp., two small	200	
Miscellaneous, including shipping	1,000	
Office equipment	200	
		$11,300
Cost one month preparatory work:		
Nolan's salary	$ 200	
Rent 1 month, less $100 sublet	150	
Heat, light, power, 1 month	150	
Sales and office manager	200	
2 men at $35 per week 3 men at $20 per week	550	
Fireman, 12 hr. at 35 cents, 30 days	126	
Watchman, 12 hr. at 35 cents, 30 days	126	
Stenographer, 1 month	90	
		1,592
		$12,892
Total expense prior to production (approximately)		$13,000

EXHIBIT 1 (*Continued*)
NOLAN MANUFACTURING CORPORATION
ESTIMATE OF FINANCIAL REQUIREMENTS

Assume 3 months to produce 1,000 each of 20 pieces			
100 each of 7 pieces			
25 each of 1 piece			
Actual manufacturing cost as per list attached (Exhibit 3)		$2,725.25	
(Metal cost includes all foundry cost)			
Plus overhead, per month:			
Nolan's salary	$ 200		
Sales and office manager	200		
Stenographer	90		
Rent $250–$100 sublet	150		
Heat, light, power	150		
Fireman	126		
Watchman	126		
Shipper, 10 hr. a day at 40 cents	104		
3 months at	$1,146	3,438.00	$ 6,163.25
Cuts, printing, advertising, office supplies, miscellaneous			1,336.75
Patents			500.00
Total expense to equip and carry for 4 months			$21,000.00
Allow for interest, emergencies, etc.			4,000.00
			$25,000.00

As utensils will be put out for sale as soon as completed, this sum should carry the enterprise until it can carry itself.

Time schedule for funds required:

At once	$15,000
End of first month	2,000
End of second month	2,000
End of third month	2,000
	$21,000

If the total shown, of, say, $25,000, be too large to raise at this time, it is possible to start on a smaller scale by getting the rolling done elsewhere, buying the bakelite handles complete, erecting only part of the machinery, and proceeding on a smaller scale. An estimate on this basis is attached (Exhibit 2).

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3 cents per piece. Such a profit on a volume of 100,000 pieces (as they often buy) would provide enough income to carry the project while more profitable lines, such as utensils, are being developed. Mr. Nolan has made a study of the design and production of such items and has many ideas for items which could be produced very quickly.

WALTER P. MERRICK.

Attached to the report were photographs of the proposed factory site in Evanston, photographs of the types of utensils to

EXHIBIT 2
NOLAN MANUFACTURING CORPORATION
ESTIMATE OF MINIMUM EXPENSE AT WHICH OPERATION COULD BE COMMENCED AND CARRIED TO A POINT WHICH SHOULD SHOW ITS POSSIBILITIES

Preliminary costs:		
Balance due on machinery (moving charge included)	$2,600	
Install and erect machinery	500	
Build two furnaces	200	
Crucibles and supplies	400	
Oil tank	50	
Foundry supplies	100	
Dies, patterns, molds	1,500	
1 tumbling barrel	50	
Polishing and buffing wheels	200	
Motors	200	
Miscellaneous	500	
Office supplies	100	$ 6,400
One month preparatory work:		
Nolan's salary	$ 200	
Rent	250	
Heat, light, power, telephone	200	
Girl for office	100	
1 man at $35 per week 2 men at $20 per week	350	
Fireman, 12 hr. at 35 cents	125	
Watchman	125	
Boy	75	1,425
Expenses, 2 months more:		
Same as first month, 2 at $1,425	$2,850	
Sales, patents, miscellaneous	1,325	4,175
Total expenses, 3 months		$12,000

During this period it should be possible to get the plant into operation, to make the temporary dies, and to produce a good number of sample pieces, sufficient to enable the obtaining of orders from chain stores, and also the introduction of castings and sheets into other plants for their own use. Expansion to a much larger capacity could then be accomplished within one month, with commercial production going on meanwhile.

be manufactured, and copies of a number of letters. One letter was from the company in Indianapolis which had obtained second-hand machinery for Mr. Nolan, and which offered to deliver it free in Chicago or vicinity if, by the end of January, 1933, he paid the remaining amount owed. Another letter was from a man who had exposed a piece of the metal to salt water for 60 days on his speed boat and found no trace of corrosion or discoloration.

Other letters were from men who were interested in acting as regional distributors for utensils and who could finance their own purchases.

1. Draw up a complete financial plan for a company organized to carry on this business.

2. On the basis of this plan, should Borden & Campbell attempt to market securities for meeting the capital requirements of the newly formed company?

EXHIBIT 3
NOLAN MANUFACTURING CORPORATION
UTENSIL COSTS

Item number	Utensil	Metal cost	Direct labor	Total manufacturing cost	Total cost (overhead 15 cents)	Price to distributors (cost +100 %)	Price to salesmen (+25 %)	Price retail (+33 %)	Profit to company per piece	Pieces per month	Profit per month
1	Pan, 3 in.	$0.10	$0.03	$0.13	$0.28	$0.60	$0.75	$1.00	$0.32	500	$ 160
1	Pan, 9 in	0 33	0 03	0.36	0.51	1.00	1.25	1.70	0.49	500	245
2	Salad spoon	0.04	0.03	0.07	0.22	0.44	0.55	0.75	0.22	500	110
3	Ladle, oval	0.04	0.03	0.07	0.22	0.44	0.55	0.75	0.22	500	110
4	Ladle, perforated	0.04	0.03	0.07	0.22	0 44	0.55	0.75	0.22	500	110
5	Vegetable spoon	0.04	0.03	0.07	0.22	0 44	0.55	0.75	0.22	500	110
6	Spoon, perforated	0.04	0.03	0.07	0.22	0.44	0.55	0.75	0.22	500	110
7	Fry pan	0.15	0.03	0.18	0.33	0.60	0.75	1 00	0.27	500	135
8	Spatula	0.03	0.03	0.06	0.21	0.42	0.55	0.75	0.21	500	105
9	Skimmer, short	0.05	0.03	0.08	0.23	0.44	0.55	0 75	0.21	500	105
10	Ladle, 18 in	0.04	0 03	0.07	0.22	0.44	0.55	0.75	0.22	500	110
11	Skimmer, 18 in	0.05	0.03	0 08	0 23	0 44	0.55	0.75	0.21	500	105
12	Spatula, big	0 08	0.03	0.11	0.26	0.52	0.65	0.90	0 26	500	130
13	Ladle, sound, short	0.04	0.03	0.07	0.22	0.44	0.55	0.75	0.22	500	110
14	Ladle, sound, 18 in	0 04	0.03	0.07	0.22	0.44	0.55	0.75	0.22	500	110
15	Spoon, perforated, square nose	0.04	0.03	0.07	0 22	0.44	0.55	0.75	0.22	500	110
16	Spatula, different shape	0.08	0 03	0 11	0.26	0.52	0.65	0.90	0.26	500	130
2c	Ladle, cast	0.12	0.06	0.18	0.33	0.60	0.75	1.00	0.27	500	135
3c	Ladle, cast	0.12	0 06	0.18	0.33	0.60	0.75	[illegible]	0.27	500	135
4c	Spoon, cast	0,12	0.06	0.18	0.33	0.60	0.75	1.00	0.27	500	135
				$2.28 × 500 = $1,140.00						10,000	$2,510
					0.52	1.00	1.25	1.70	0.48	100	48
				37.00	0.52	1.00	1.25	1.70	0.48	100	48
7	Fry pan, 9½ in.	0.33	0.04	[illegible] × 100 = 93 00	1.08	2.00	2.50	3.50	0.92	100	92
17	Mix bowl, 5 by 4 in.	[illegible]	0.08	0.20 × 100 = 20 00	0.35	0.60	0.75	1.00	0.25	100	25
17	Mix bowl, 10 by 5 in.	0.80	0.08	0 88 × 100 = 88.00	1.03	2.00	2.50	3.50	0.97	100	97
1c	Pan, [illegible] by 1½ in.	0.32	0.08	0.40 × 100 = 40 00	0.55	1.00	1.25	1.70	0.45	100	45
[illegible]	[illegible] pan, 9½ by 1½ in.	0.80	0.08	0.88 × 100 = 88.00	1.03	2.00	2.50	3.50	0.97	100	97
7c	Round griddle, 12 in.	1.60	0.09	1.69 × 50 = 84.50	1.84	3.60	4.50	6.00	1.76	50	88
				$ 487.50						750	$ 540
				+1,140.00							
				Manufacturing cost of 10,750 pieces = $1,627.50						10,750	$3,050

EXHIBIT 3 (*Continued*)

NOLAN MANUFACTURING CORPORATION

UTENSIL COSTS

Annual profit at 10,000 pieces per month equals $36,000+ on an investment of $25,000 to $30,000.

Explanation of Utensil Costs.—Nolan shows a metal cost (No. 2 metal) of 38 cents per pound, and in *his* calculation of utensil costs he has charged the metal at 55 cents per pound, giving a profit at once to the foundry. In the foregoing calculations I have charged metal at about 44 cents per pound, which seems to allow a fair margin of safety.

In a longer report, which is available, Nolan gives detailed figures showing the metal required for each utensil, with proper allowance for waste in trimming. No allowance is made for the value of this metal for reuse by remelting, although this would be a substantial factor.

Nolan's figures include an arbitrary overhead cost applied to each piece, but his figure is believed to be too low, and I have thought it better to figure the entire plant overhead separately, as is shown later.

In the attached tabulation, the metal cost includes the foundry labor and supplies; the direct labor on subsequent manufacturing operations is made slightly larger than Nolan's figures.

The total manufacturing cost as shown, therefore, includes metal cost and all direct labor. It has previously been shown that the total overhead charges per month are about $1,100 ($1,425 − $350); if this be increased to $1,500 per month to allow additional sales expense, advertising, etc., and if a production of 10,000 pieces per month be assumed (much less than capacity) a rough figure is reached of 15 cents overhead per article. This, added to the direct cost gives the total cost, as shown; to arrive at the selling cost (price to distributors), approximately 100 % is added. For information, the distributor's prices to salesmen and the retail prices are also shown.

3. LERNER LAMP COMPANY

PROMOTION OF COMPANY TO MANUFACTURE VAPOR LAMPS

In May, 1934, the attention of the American Promotion Company, a concern engaged in launching new enterprises in the manufacturing field, was directed to an improved type of electric light, the invention of a German scientist named Lerner. Formerly a professor in a European university, Mr. Lerner had done considerable research and developmental work on radio tubes and electric lamps; he also had marketed successfully the patents to several radio devices. In order to exploit in this country his improved electric lamp, Mr. Lerner was seeking at that time financial and business backing.

In the new lamp, vapor instead of the customary filaments served as a conductor of electric current. The use of vapor lamps heretofore had been limited to a very narrow field because of their cumbersome size, relative inefficiency, and poor quality of light. For the operation of these lamps, furthermore, transformers were necessary to obtain high voltages, and an individual installation was required for each lamp. In contrast to this older type of vapor lamp, Mr. Lerner's product was twice as efficient as the usual incandescent lamp, operated on an ordinary voltage circuit without a transformer, was compact, and could be used in a standard light socket. The quality of the light, though more nearly white than that of other vapor lamps, was somewhat deficient in red; it was, therefore, at a comparative disadvantage with incandescent bulbs for home lighting. Notwithstanding that its color quality, intensity, and high efficiency pointed to out-of-door and factory lighting as its initial field, Mr. Lerner hoped eventually to adapt it for home lighting. Under licenses from Mr. Lerner the lamp had been manufactured in Europe for two years and was giving satisfactory service in a number of installations.

Mr. Lerner received a cash and royalty offer for the device from a leading American electrical concern at about the time he granted the European licenses but rejected it as too low. After he came to America in 1933, he formed the Lerner Lamp Company and began to make lamps in a laboratory with the expectation of

soon obtaining sufficient financial support to commence production on a more extensive scale.

Before reaching a decision in regard to the advisability of financing the Lerner Lamp Company, the American Promotion Company had the lamp thoroughly tested by the Industrial Laboratories, Inc., which submitted a satisfactory report. Since this concern reported only facts and gave no advice, the American Promotion Company employed as consultant Mr. Albright, an expert on vapor lamps. He stated that, whereas the lamps were relatively expensive to make by hand in the laboratory, they could readily be adapted to machine production, a conclusion which was substantiated by Mr. Lerner's statement that the lamps were manufactured by machine abroad. In Mr. Albright's opinion, machine methods would permit the production of the lamps at a lower cost than competitive flood- and factory-lighting bulbs, even with a relatively small volume. He believed, moreover, that, when the time came to exploit the residential field, production costs would be as low as for ordinary incandescent lamps.

A check on the patent situation by the American Promotion Company's patent attorney indicated that the patents could be defended under broad and strong claims.

EXHIBIT 1
LERNER LAMP COMPANY
APPROXIMATE BALANCE SHEET, AS OF APRIL 30, 1934

ASSETS	
Cash	$ 3,000
Accounts Receivable	1,500
Inventories	1,500
Machinery and Equipment	8,000
Patents	100,000
License Contracts	86,000
Total Assets	$200,000
LIABILITIES	
Accounts Payable	$ 3,800
Capital Stock	200,000
Less: Deficit	3,800
Total Liabilities	$200,000

The most important products competing with Mr. Lerner's lamp were a low-efficiency mercury-vapor lamp and a sodium-

vapor lamp which the General Electric Company was developing for highway lighting. At the time of the investigation, one of the leading electrical companies brought out a vapor lamp which appeared to be a copy of the lamp manufactured by its foreign affiliate under a license from the Lerner Lamp Company.

Upon the completion of the investigation, the officers of the American Promotion Company informed Mr. Lerner that they had given considerable financial assistance to less promising enterprises in the past, but in view of the unliquid condition of their company they could make no definite large commitment at the moment. Inasmuch as the Lerner Lamp Company was receiving royalties from the European licensees, as well as obtaining sufficient orders in this country to carry the overhead on the laboratory, the officers of the American Promotion Company considered that the immediate need was not primarily for liquid funds, but for "influential backing, business, technical, and legal advice, and, furthermore, negotiating ability when and if the time came to sell this company to one of the large electrical concerns." Accordingly, they submitted to Mr. Lerner the following proposition which assumed that Mr. Lerner would donate the necessary shares of stock to the company's treasury:

Proposed Articles of Agreement

To be made and entered into by and between the American Promotion Company, hereinafter called the First Party, and Mr. Karl Lerner, hereinafter called the Second Party.

A. The First Party agrees to provide the Lerner Lamp Company, at present entirely owned by the Second Party, with the following:

1. Manufacturing and office space at Forty-sixth Street as long as the space remains idle, accruing a nominal rental to be paid only when profits are realized, or if the First Party withdraws from the undertaking at the request of the Second Party. If the First Party requests that the space be vacated without providing other adequate space, six months' accruals will be cancelled.
2. A motor-generator set to make available both direct and alternating current. (This can be purchased secondhand for about $450 and will remain the property of the First Party. The loss in event of resale should not exceed $100.)
3. Reimbursement for the expenses of moving (around $50).
4. A combined office manager, accountant, purchasing agent, and secretary, who can be secured for $1,800 a year at the beginning.
5. Legal advice.

6. The prestige, experience, and negotiating ability of Mr. Albright and Mr. Foote on the board of directors.

(On this basis the maximum cash outlay of the First Party will be approximately $2,000 in addition to services rendered.)

B. In return for the foregoing, the First Party is to receive the following:

1. Five per cent of the stock of the Lerner Lamp Company, of which one-fifth will be allotted to Mr. Albright.
2. An additional 1% of the stock for each additional $1,000 cash put into the company up to $40,000, making the holdings of the First Party total 45% of the entire capital stock of the company. This shall not constitute an obligation to advance further funds. Stock thus acquired will remain the property of the First Party regardless of continued connection with the company; in the event that the company is sold and the active management and financial support of the First Party withdrawn, the First Party agrees to sell its stock for the larger of (*a*) the price per share at which the remainder of the stock is sold, or (*b*) $3,000 for each 1% owned.
3. First refusal of new financing up to the $40,000 indicated in item 2 above, and also for two years the opportunity to purchase control by acquiring another 10% of the stock for $45,000. If the First Party is not in a position to provide further financing, assistance will be given the company in obtaining funds from other sources.
4. A division of the proceeds proportionate to stock ownership, if the First Party is instrumental in negotiating the sale of the company for $170,000 net or less, plus the cash investment of the First Party; and, if for more than this amount, a division of the proceeds proportionate to stock ownership up to $170,000 plus the cash investment of the First Party, and an equal division of the excess above it.
5. A guarantee that, if the Lerner Lamp Company operates successfully and grows to such a size as to warrant it, Mr. Albright will be hired by the company, his position and remuneration to be determined by the board of directors.
6. A guarantee that, if the company is sold under the conditions outlined in Item 4 above, Mr. Albright will receive 4% of the "excess" for his services before the equal division specified, less any salary paid him before the sale.
7. A guarantee that, if the First Party acquires control as in Item 3 and desires to sell the company, the Second Party will sell his 45% interest for the larger of (*a*) the price per share at which the remainder of the stock is sold, or (*b*) $4,500 for each 1% owned on the present basis.

Shortly after the submission to Mr. Lerner of this tentative agreement, a manufacturer of electrical appliances became interested in obtaining control of the patents and made an offer involving a much larger immediate cash consideration. In

consequence, Mr. Lerner hesitated to accept the proposal of the American Promotion Company, particularly since the new offer made available funds with which to contest the patent suits he regarded as imminent. For this purpose he estimated that the company would require at least $20,000. He considered, moreover, that an additional $5,000 should be provided for the purchase of new automatic machinery.

1. Was the proposed agreement between the American Promotion Company and Mr. Lerner a satisfactory plan for placing the Lerner Lamp Company in a position to realize the best return possible on its patented lamp? Was the agreement equitable?

2. Suggest alternative plans for meeting Mr. Lerner's requirements.

3. Compare the promotion of the Lerner Lamp Company with promotions described in Borden & Campbell and West Coast Trading Corporation, with special reference to (*a*) degree of risk involved, (*b*) amount of capital necessary to establish the companies on a profit-making basis, and (*c*) prospects for highest return on the capital invested.

4. CONSOLIDATED WAREHOUSES, INC.[1]

PROMOTION OF CHAIN OF WAREHOUSES

Mr. Thomas Bailey, a member of the investment firm of Peirson, Child & Company, in 1926 submitted a plan for a chain warehouse promotion to the president of the company and suggested that its securities might be a desirable origination. In a study of existing facilities, Mr. Bailey concluded that by far the greater part of existing storage reservoirs consisted of old, nonfireproof, unclean, inconvenient, and poorly located warehouses, and that Albany, Cleveland, and Detroit had relatively little warehouse space. He suggested these cities as possible sites.

Mr. Douglas, the president of Peirson, Child & Company, was impressed by the possibilities of organizing and financing a warehouse business, since keen competition among investment firms had made good securities difficult to obtain. By establishing a warehouse system, his firm could obtain bonds for sale and at the same time retain common stock necessary for control, which would become valuable as the company progressed. It would be necessary, however, for Peirson, Child & Company to assume the entire responsibility, which included obtaining construction estimates, organizing the business, and selecting a manager, as well as selling the securities.

Peirson, Child & Company had financed several new companies. During 1926, for example, the company had syndicated $2,700,000 first mortgage 6½% bonds of the Bantom Terminal Company, a new warehouse, and also $1,600,000 first mortgage 6½% bonds of the Western Power Company, a utility promotion.

Mr. Douglas employed engineering and appraisal firms to study the warehouse needs of Albany, Cleveland, and Detroit. The engineers reported favorably on all three cities.

ALBANY

McHenry and Walker, construction engineers, reported that Albany lacked adequate storage space.

In computing the probable revenues of an Albany warehouse (see Exhibit 1), the engineers estimated the net available space

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

for storage in the proposed building and applied the base rate per square foot per month then obtaining in warehouses of the same class with fireproof construction, with good trucking and warehouse facilities, and under competent management.

The engineers concluded that such a warehouse, if constructed as they proposed, equipped with the proper mechanical and cold-storage equipment, and placed in operation under competent management, should show approximately the net earnings indicated in Exhibit 1 after the second year of operation. It would take 12 months of operation for the monthly gross revenues to meet all monthly operating expenses. In the second year, the warehouse should have sufficient revenue to pay all operating expenses and other fixed charges. Revenue would be available from insurance brokerage on stored goods in addition to interest from excess working capital and office-space rentals. Under the normal operation, $601,104 would be available for taxes, insurance, interest, and sinking fund requirements in the third year.

Another firm of engineers estimated the cost of the proposed building at $3,550,000, exclusive of land. The United Appraisal Company stated that the investment necessary to place the plant on a going-concern basis would be in excess of $4,089,000.

EXHIBIT 1

ESTIMATED EARNINGS, ALBANY PLANT—THIRD YEAR

ESTIMATED REVENUES		
General merchandise storage	$162,322	
Cold storage	406,022	
Labor handling, in and out	79,300	
500 pool cars at $75 per car	37,500	
Insurance, interest, cooperage, and clerical work	30,000	
Cartage	30,000	
3,200 sq. ft. of office space at $2	6,400	
Estimated gross earnings		$751,544
ESTIMATED COSTS		
General manager and assistant, office force, and miscellaneous	$ 50,000	
Warehouse superintendent and assistant	12,000	
Labor	31,720	
Engineers' department, including janitor, heat, power, maintenance, and elevator operators	56,720	
Estimated cost of operation		150,440
Estimated net revenue available for taxes, insurance, interest, sinking fund, and dividends		$601,104

The vice president of the New York Central Railroad wrote: "It is my opinion that there is need for such a plant at Albany and an opportunity to handle the project successfully because, with the growth of business in the country, the need for warehouses is developing very rapidly."

CLEVELAND

McHenry and Walker recommended a 12-story warehouse in Cleveland to be approximately 175 ft. by 214 ft. They estimated that a warehouse in Cleveland, if constructed in accordance with the plans, should show approximately the net returns indicated in Exhibit 2 in the third year of operation. After two years the earnings should be sufficient to pay all operating expenses and other fixed charges.

EXHIBIT 2
ESTIMATED EARNINGS, CLEVELAND PLANT—THIRD YEAR

ESTIMATED REVENUES		
Cold storage department	$428,068	
General merchandise storage	106,825	
Revenue from handling charges	99,360	
500 pool cars at $75 per car	37,500	
Breaking bulk in 300 cars at $25 per car	7,500	
3,200 sq. ft. of office space at $2	6,400	
30,000 tons of ice at $4 per ton	120,000	
Insurance, interest, cooperage, and clerical work	25,000	
Cartage	25,000	
Estimated gross earnings		$855,653
ESTIMATED COSTS		
General manager, assistant, office force, and miscellaneous	$ 50,000	
Warehouse superintendent and assistant	12,000	
Handling labor	47,000	
Ice manufacture	30,000	
Engineers' department, including janitor, heat, power, maintenance, and elevator operators	57,720	
Estimated costs of operation		196,720
Estimated net revenue available for taxes, insurance, sinking fund, interest, and dividends		$658,933

Danforth and Company estimated the cost of this building, exclusive of land, at $3,540,000. The United Appraisal Company calculated that the investment necessary to put the warehouse in operation would be $4,050,000.

The general manager of the "Nickel Plate" Railroad in expressing his willingness to assist the project said, "It will naturally be our desire to cooperate with the company operating a warehouse on our line to the end of increasing the business of both companies."

DETROIT

McHenry and Walker considered that the Grand Trunk Railroad needed terminal facilities at Detroit. Since this railroad was controlled by the Canadian National Railway, it was legally unable to invest in a warehouse enterprise in the United States. The general manager of the Grand Trunk Railroad stated that the railroad would be glad to distribute to all its agents and representatives in the United States, Canada, and Europe any pamphlets on the warehouse that the company might desire to publish, and that the railroad employees would be instructed to canvass for consignments, send information, and solicit business for the Detroit warehouse exclusively, unless otherwise instructed by consignees or consignors.

EXHIBIT 3
ESTIMATED EARNINGS, DETROIT PLANT—THIRD YEAR

ESTIMATED REVENUES		
General merchandise storage	$172,273	
Cold storage	400,050	
Revenue from labor in handling	87,260	
Revenue from ice plant—30,000 tons at $4	120,000	
Revenue from pool cars—500 cars at $75 per car	37,500	
Revenue from brokerage, insurance, interest, cooperage, and clerical work	25,000	
Cartage	25,000	
Estimated gross earnings		$867,083
ESTIMATED COSTS		
Clerical force and general management	$ 50,000	
Warehouse superintendent and assistant	12,000	
Labor	34,904	
Ice plant—operation and labor costs	30,000	
Engineers' department, including maintenance, elevator operator, power, heat, janitor service, and watchman	59,720	
Estimated costs of operation		186,624
Estimated net revenue available for taxes, interest, insurance, sinking fund, and dividends		$680,459

In view of the support of the railroads, the engineers concluded that, despite the large amount of new storage space constructed in Detroit in the previous year, there was not an excess of storage space per capita. The available space would be absorbed quickly, and a large volume of storage in transit, formerly held at other points, would now come to Detroit.

The engineers estimated that by the second year gross revenues would cover operating expenses and fixed charges and by the third year earnings would be approximately as shown in Exhibit 3.

The cost of a building at Detroit was estimated at $3,500,000 by Danforth and Company and the going-concern investment was estimated at $4,033,000 by the United Appraisal Company.

After receipt of the engineers' reports and railroad correspondence, Mr. Bailey formulated a plan for financing the warehouse promotion. He proposed a holding company, Consolidated Warehouses, Inc., which would own all the capital stock and junior bonds of three subsidiaries to be located at Albany, Cleveland, and Detroit. This would be the nucleus of a warehouse chain with other units to be located at advantageous places. First mortgage bonds on the warehouses as security, collateral trust bonds supported by the capital stock, and junior bonds of the three subsidiaries would be issued.

An expert warehouse manager employed by the holding company would be selected to supervise the operation of the warehouses, solicit business, and effect operating economies.

The engineers estimated that in the third year the net earnings of the subsidiaries available for taxes, interest, insurance, sinking fund, and dividends would be $1,940,496, as shown in Exhibit 4. A summary of the appraisals (Exhibit 5) indicates that the

EXHIBIT 4

ESTIMATED NET EARNINGS OF THE SUBSIDIARY COMPANIES—THIRD YEAR

Albany warehouse	$ 601,104
Cleveland warehouse	658,933
Detroit warehouse	680,459
Total	$1,940,496

operating warehouses would cost approximately $13,200,000. Exhibit 6 shows the estimated earnings with interest, taxes, and sinking fund requirements of the proposed consolidated company from 1927 to 1951.

EXHIBIT 5
SUMMARY OF APPRAISALS OF THE SUBSIDIARY COMPANIES

Location	Cost of building	Going-concern investment*	Appraised value of land†
Albany	$ 3,550,000	$ 4,089,000	$ 95,000
Cleveland	3,540,000	4,050,000	214,143
Detroit	3,500,000	4,033,000	700,000
	$10,590,000	$12,172,000	$1,009,143

* Exclusive of land.
† Appraisals by Neale and Company, Albany, Omar Appraisal Company, Cleveland; and the Union Bank, Detroit.

EXHIBIT 6
SERVICE FOR FUNDED DEBT AND ESTIMATED APPLICABLE NET EARNINGS, AFTER TAX RESERVES, OF CONSOLIDATED WAREHOUSES, INC., AND SUBSIDIARIES

Number	Year	Interest and sinking fund requirements on all bonds issued	Estimated applicable net earnings after reserve for taxes	Balance applicable to preferred and common dividends
1	1927	$630,500		
2	1928	630,500	$ 630,500	
3	1929	630,500	1,200,000	$ 569,500
4	1930	630,500	1,750,000	1,119,500
5	1931	630,500	1,750,000	1,119,500
6	1932	903,500	1,750,000	846,500
7	1933	902,350	1,750,000	847,650
8	1934	903,375	1,750,000	846,625
9	1935	904,280	1,750,000	845,720
10	1936	903,950	1,750,000	846,050
11	1937	904,485	1,750,000	845,515
12	1938	903,655	1,750,000	846,345
13	1939	903,560	1,750,000	846,440
14	1940	904,070	1,750,000	845,930
15	1941	904,005	1,750,000	845,995
16	1942	903,300	1,750,000	846,700
17	1943	902,940	1,750,000	847,060
18	1944	903,845	1,750,000	846,155
19	1945	903,720	1,750,000	846,280
20	1946	902,500	1,750,000	847,500
21	1947	879,120	1,750,000	870,880
22	1948	881,015	1,750,000	868,985
23	1949	880,310	1,750,000	869,690
24	1950	879,105	1,750,000	870,895
25	1951	945,520	1,750,000	804,480

Mr. Bailey proposed the following financing:

Albany Warehouse Company.....	\$2,400,000 first (closed) mortgage 6½% sinking fund gold bonds
Cleveland Warehouse Company...	\$2,200,000 first (closed) mortgage 6½% sinking fund gold bonds
Detroit Warehouse Company.....	\$2,100,000 first (closed) mortgage 6½% sinking fund gold bonds
Consolidated Warehouses, Inc.....	\$3,000,000 6½% convertible debenture bonds, Series A

The Series A debenture bonds were to be secured by deposit with a trustee of all the common stock and \$3,750,000 of 6% sinking fund bonds due April 1, 1951, of the three subsidiary companies. The deposited bonds were to be secured by a direct mortgage on the terminal properties, subject to the closed first mortgages totaling \$6,700,000. The Consolidated Warehouses, Inc., debenture bonds were to be convertible on and after October 1, 1928, into 11 shares of preferred stock for each \$1,000 bond.

The sinking fund provisions of the Albany, Cleveland, and Detroit subsidiary mortgage bonds as well as of the Consolidated Warehouses, Inc., debenture bonds, all of which were to become effective in April, 1932, were estimated to be sufficient to redeem the various issues at or before maturity, through purchase or call at 105 or less. Only the bonds were to be sold immediately; the common stock and the preferred stock of the Consolidated Warehouses, Inc., were to be sold when additional funds were required.

The total investment necessary to place the three warehouses on a going-concern basis Mr. Bailey estimated at \$13,181,143. The proposed capitalization of the Consolidated Warehouses, Inc., was \$3,000,000 of 6½% convertible debenture bonds, \$2,552,600 of 7% preferred stock, and 300,000 shares of no-par common stock; Mr. Bailey maintained that this capitalization compared favorably with that of other warehouse companies (see Exhibit 7).

A manager who had had experience in operating a warehouse in Trenton, New Jersey, could be obtained immediately to manage the warehouses. Later, a more expert warehouse manager would be secured to supervise the entire business.

EXHIBIT 7

COMPARISON OF CONSOLIDATED WAREHOUSES, INC., WITH SEVERAL OTHER RECENTLY FINANCED STORAGE PROPERTIES

Item	Detroit Rail & Harbor Terminal	Montreal Rail & Water Terminal	Canadian Rail & Harbor Terminal, Toronto	Consolidated Warehouses, Inc.
Total square feet of warehouse	900,000	600,000	1,000,000	1,500,000
Square feet of cold storage	200,000	150,000	225,000	770,000
Square feet of general storage	700,000	450,000	775,000	730,000
Equivalent square feet general storage*	333,333	250,000	375,000	1,283,333
Total equivalent square feet of warehouse	1,033,333	700,000	1,150,000	2,013,333
First mortgage bonds	$3,750,000	$3,000,000	$3,500,000	$ 6,700,000
Junior bonds	1,750,000	800,000	2,000,000	3,000,000
Preferred stock	1,930,000	600,000	950,000	2,552,600
Total preferred stock and bonds	$7,430,000	$4,400,000	$6,450,000	$12,252,600
Bonds per equivalent square foot	$5.32	$5.43	$4.78	$4.82
Bonds and preferred stock per equivalent square foot	$7.19	$6.29	$5.61	$6.09
Estimated earnings per share of common stock after deducting for Federal taxes	$2.71	$1.27	$3.95	$3.01†
Estimated earnings times first mortgage interest	5 times	3.5 times	5 9 times	4.46 times†
Estimated earnings times all bond interest	3.8 times	2.75 times	3.6 times	3.1 times†

* Cold-storage space costs considerably more and earns more than general-storage space; to facilitate comparisons, the number of square feet of cold storage was multiplied by 5/3 to obtain "equivalent square feet of general storage."

† Estimated earnings based upon engineers' reports.

Should Peirson, Child & Company have undertaken the proposed promotion of the Consolidated Warehouses, Inc.?

5. MID-WEST GAS PROPERTIES

PROPOSAL FOR FORMING COMPANY TO ACQUIRE GAS PROPERTIES

Barrett, Brooks & Company, a Chicago investment banking concern specializing in public utility issues, conducted in the summer of 1933 a study of four medium-size utility companies. The banking firm planned to form a new company which would acquire the franchises and other assets pertaining to the gas properties of the group as soon as security market conditions once more permitted the flotation of new issues. From a more comprehensive report submitted by its research staff the following excerpts were taken:

Companies.—The four companies whose gas holdings are analyzed in this report are

Cumberland Gas and Electric Company.
Lincoln Gas and Electric Company.
Thornton Gas Light Company.
Windsor Electric Company.

Three of these companies are predominantly electric, the gross revenues of the Cumberland Gas and Electric Company, the Lincoln Gas and Electric Company, and the Windsor Electric Company being 67%, 60%, and 93% electric, respectively. The Thornton Gas Light Company, alone, is engaged exclusively in the gas business. The analyses presented in this report relate to their gas properties only.

EXHIBIT 1

Company	Gross operating revenue from gas sales, 1932	Number of customers' meters, Dec. 31, 1932	Gas property, cost less depreciation, Dec. 31, 1932
Cumberland Gas and Electric Company	$ 876,475	30,215	$ 2,963,828
Lincoln Gas and Electric Company	493,819	12,723	983,124
Thornton Gas Light Company	2,088,030	48,650	6,432,376
Windsor Electric Company	102,459	2,318	232,975
	$3,560,783	93,906	$10,612,303

Territories Served.—Two of the companies, the Thornton Gas Light Company and the Lincoln Gas and Electric Company, serve a number of suburban cities and towns on the southern outskirts of Chicago;

the Cumberland Gas and Electric Company operates in a fair-sized industrial city about 12 miles from Chicago, adjoining the territory covered by the Thornton Gas Light Company; the fourth company, the Windsor Electric Company, serving a territory contiguous to none of the other properties, furnishes gas to a small city and two towns nearly 25 miles south of Chicago. In 1930 the total population of the communities within the area served by the four companies was 401,384 (see Exhibit 2).

EXHIBIT 2

POPULATION AND CUSTOMERS' METERS INSTALLED IN CITIES AND TOWNS SERVED

Location	Population, 1930 census	Customers' meters, Dec. 31, 1932	Persons per meter
Thornton Gas Light Company:			
Thornton	59,789	14,261	4.2
South Thornton	24,923	6,484	3.8
Glenbrook	61,467	14,751	4 2
Patten	50,178	10,770	4.7
Farmingdale	12,814	2,384	5.4
	209,171	48,650	4.3
Lincoln Gas and Electric Company:			
Lincoln	15,888	4,071	3.9
Auburn	30,331	6,587	4.6
East Auburn	6,313	2,064	3.1
	52,532	12,722	4.1
Cumberland Gas and Electric Company:			
Cumberland	92,029	23,256	4.0
Hampton	31,038	6,959	4.5
	123,067	30,215	4.1
Windsor Electric Company:			
Windsor	14,092	2,185	6.4
East Windsor	2,522	133	19 0
	16,614	2,318	7 2
Grand total	401,384	93,905	4.3

Since there is already one meter installed for every 4.3 persons living in the territory, it may be concluded that very few homes lack gas service, and that all four companies have long since passed through the developmental period of rapid growth. They are compact units, thoroughly covering their territories, and therefore no longer subject to the vicissitudes of struggling and unpredictable expansion.

Physical Properties.—The Cumberland Gas and Electric Company and the Thornton Gas Light Company own gas generating plants, whereas the Lincoln Gas and Electric Company secures its entire supply

from the Thornton Gas Light Company; the Windsor Electric Company buys from utilities not included in the group under consideration. Purchases by the group from outsiders and sales to outsiders by members of the group tend to balance, as the following table shows.

EXHIBIT 3
PURCHASES OF GAS

Purchaser	Seller	M.C.F.	Amount
Lincoln Gas and Electric Company.	Thornton Gas Light Company	380	$225,549
Windsor Electric Company.	Outsiders	55	36,049
Thornton Gas Light Company..................	Outsider	1	524
		436	$262,122

SALES OF GAS

Purchaser	Seller	M.C.F.	Amount
Lincoln Gas and Electric Company........ . .	Thornton Gas Light Company	380	$225,549
Outsiders........	Thornton Gas Light Company	95	56,569
		475	$282,118

The more important physical properties used for the production and distribution of gas are listed in Exhibit 4.

EXHIBIT 4
PHYSICAL PROPERTIES

Cumberland Gas and Electric Company.
Coal-gas generating plant, 24-hr. capacity, 1.87 M.C.F.
Water-gas generating plant, 24-hr. capacity, 4.2 M.C.F.
Gas holders, capacity, 2.4 M.C.F.
Street mains, 237.2 miles.
Lincoln Gas and Electric Company.
No generating plant.
Gas holders, capacity, 2.3 M.C.F.
Street mains, 101.0 miles.
Thornton Gas Light Company.
Coal-gas generating plant, 24-hr. capacity, 3.4 M.C.F.
Water-gas generating plant, 24-hr. capacity, 7.3 M.C.F.
Gas holders, capacity, 3.4 M.C.F.
Street mains, 383.0 miles.
Windsor Electric Company.
No generating plant.
Gas holders, capacity, 0.18 M.C.F.
Street mains, 38.8 miles.
Entire group.
Coal-gas generating plant, 24-hr. capacity, 5.27 M.C.F.
Water-gas generating plant, 24-hr. capacity, 11.5 M.C.F.
Gas holders, capacity, 8.28 M.C.F.
Street mains, 760.0 miles.

The book values of these properties on December 31, 1932 total $10,612,303 (see Exhibit 5).

EXHIBIT 5
MID-WEST GAS PROPERTIES
BALANCE SHEET, AS OF DECEMBER 31, 1932

Item	Total—all companies	Cumberland Gas and Electric	Windsor Electric	Thornton Gas Light	Lincoln Gas and Electric
ASSETS					
Plant and Equipment—Gas	$12,584,953	$3,628,980	$ 273,201	$7,437,103	$1,245,669
Less: Reserve for Depreciation	1,972,650	665,152	40,226	1,004,727	262,545
Net Plant and Equipment—Gas	$10,612,303	$2,963,828	$ 232,975	$6,432,376	$ 983,124
Plant and Equipment—Electric	14,051,895	6,401,008	5,634,260	....	2,016,627
Less: Reserve for Depreciation	2,008,960	879,886	808,221	....	320,853
Net Plant and Equipment—Electric	$12,042,935	$5,521,122	$4,826,039	....	$1,695,774
Total Net Plant and Equipment	$22,655,238	$8,484,950	$5,059,014	$6,432,376	$2,678,898
Miscellaneous Physical Property	33,217	....	18,782	589	13,846
Other Investments	798,955	5,605	191,850	436,500	165,000
Cash	1,076,207	305,404	216,929	342,907	210,967
Notes and Accounts Receivable	1,003,279	347,435	170,995	228,649	256,200
Materials and Supplies	746,233	289,289	144,158	245,352	67,434
Total Current Assets	$ 2,825,719	$ 942,128	$ 532,082	$ 816,908	$ 534,601
Prepaid Accounts	33,854	4,982	10,497	11,029	7,346
Unadjusted Debits	40,432	7,255	23,060	1,334	8,783
Total Assets	$26,387,415	$9,444,920	$5,835,285	$7,698,736	$3,408,474
LIABILITIES					
Accounts Payable	$ 298,738	$ 66,787	$ 34,232	$ 67,863	$ 129,856
Notes Payable	645,000	....	155,000	440,000	50,000
Consumers' Deposits	142,662	35,724	18,090	44,548	44,300
Accrued Taxes, Interest, etc	326,650	131,720	46,240	107,516	41,174
Total Current Liabilities	$ 1,413,050	$ 234,231	$ 253,562	$ 659,927	$ 265,330
Funded Debt	3,625,000	1,500,000	650,000	725,000*	750,000
Common Stock	14,567,550	4,700,000	2,990,725	5,312,200	1,564,625
Premium on Stock	3,609,704	1,417,746	1,344,919	450,237	396,802
Reserves	40,448	12,905	15,000	5,300	7,243
Surplus	3,131,663	1,580,038	581,079	546,072	424,474
Total Liabilities	$26,387,415	$9,444,920	$5,835,285	$7,698,736	$3,408,474

* Coupon notes paid off at maturity, February 1, 1933.

EXHIBIT 6
MID-WEST GAS PROPERTIES
STATEMENTS OF GAS OPERATIONS FOR THE YEAR ENDED
DECEMBER 31, 1932

Item	Total—all companies*	Cumberland Gas and Electric	Windsor Electric	Thornton Gas Light	Lincoln Gas and Electric
Sales to consumers	$3,277,770	$876,475	$102,446	$1,805,035	$493,814
Sales to gas companies	56,569	....	....	282,118	
Miscellaneous gas revenues	895	....	13	877	5
Total gas revenues	$3,335,234	$876,475	$102,459	$2,088,030	$493,819
Production expenses	1,454,024	491,074	39,146	923,804	225,549
Less: Sales of residuals	602,358	225,469		376,889	
Net production expenses	$ 851,666	$265,605	$ 39,146	$ 546,915	$225,549
Distribution expenses	220,953	55,396	7,638	124,395	33,524
Utilization expenses	39,117	14,560	1,989	17,584	4,984
Depreciation	237,980	70,000	7,202	140,868	19,910
Commercial and new-business expense	292,865	53,048	8,386	184,906	46,525
Miscellaneous expenses	239,324	49,970	10,128	140,781	38,445
Total operating expenses	$1,881,905	$508,579	$ 74,489	$1,155,449	$368,937
Net operating revenues	1,453,329	367,896	27,970	932,581	124,882
Uncollectible operating revenues	33,908	12,680	949	15,939	4,340
Taxes	552,146	154,996	14,491	335,097	47,562
Net operating income	$ 867,275	$200,220	$ 12,530	$ 581,545	$ 72,980
Nonoperating income	26,665	4,007[d]	546	26,882	3,244
Total income	$ 893,940	$196,213	$ 13,076	$ 608,427	$ 76,224
Interest and debt expenses	111,884	28,444	2,032	64,582	16,826
Net income	$ 782,056	$167,769	$ 11,044	$ 543,845	$ 59,398

* Intergroup sales and purchases not included.
[d] Deficit.

Earnings and Expenses.—In Exhibit 6 are shown the 1932 gas operating statements of each of the four companies and the totals from which intergroup sales and purchases have been eliminated. A portion of the revenues of the Cumberland Gas and Electric and the Thornton Gas Light Companies is obtained from the sale of residuals (see Exhibit 7).

EXHIBIT 7
REVENUE FROM SALE OF RESIDUALS, 1932

Residuals	Cumberland Gas and Electric Company	Thornton Gas Light Company
Coke	$174,332	$107,286
Coal-gas tar	14,402	55,244
Water-gas tar	....	46,193
Ammoniacal liquor	6,263	6,795
Other residuals	....	1,667
Total	$194,997	$217,185

The following operating ratios show the expected variation between the two companies which generate gas and those which rely on outside sources.

EXHIBIT 8

OPERATING RATIOS,* 1932

Thornton Gas Light Company	55.34%
Lincoln Gas and Electric Company	74.71
Cumberland Gas and Electric Company	58.03
Windsor Electric Company	72.70
All companies	56.42%

* Intergroup sales and purchases not included.

As an aid in determining the relative investment values of the various properties, the 1932 ratios of net operating income and depreciation to depreciated plant values are given in Exhibit 9.

EXHIBIT 9

RATIOS OF NET OPERATING INCOME AND DEPRECIATION TO DEPRECIATED PLANT VALUE, 1932

Company	Ratio of net operating income to depreciated plant value, per cent	Ratio of depreciation to depreciated plant value, per cent
Thornton Gas Light Company	9.04	2.19
Lincoln Gas and Electric Company	7.42	2.03
Cumberland Gas and Electric Company	6 76	2.36
Windsor Electric Company	5.38	3.09
All companies	8 17	2.24

Trend of Earnings.—The gross earnings and net income of the Thornton Gas Light Company, which furnishes over two-thirds of the group's combined net income, are tabulated for the period 1928–1932 in Exhibit 10.

EXHIBIT 10

THORNTON GAS LIGHT COMPANY

Item	1928	1929	1930	1931	1932
Gross earnings	$1,987,590	$2,055,644	$2,153,951	$2,173,786	$2,088,030
Net income	373,029	481,518	530,237	542,372	543,845

This indication of the stability of earnings is strengthened by the figures of the physical volume of gas sales given in Exhibit 11. It is, therefore, possible to take the 1932 earnings figures as representing

an average year. This must not, however, be regarded as an assertion that utilities are indefinitely depression-proof. For this group of gas companies, in the first five months of 1933 earnings fell off, and one company even showed a deficit (see Exhibit 12).

EXHIBIT 11
SALES OF GAS
(In millions of cubic feet)

Year	Thornton Gas Light Company	Lincoln Gas and Electric Company	Cumberland Gas and Electric Company	Windsor Electric Company	Total*
1927	1,640	339	811	53	2,843
1928	1,686	346	764	56	2,852
1929	1,763	356	770	58	2,947
1930	1,845	359	778	58	3,040
1931	1,855	364	779	53	3,051
1932	1,792	351	674	49	2,866

* Intergroup sales not eliminated.

EXHIBIT 12
NET EARNINGS, JANUARY 1 TO MAY 31, 1932 AND 1933

Company	1932	1933
Thornton Gas Light Company	$214,434	$164,620
Lincoln Gas and Electric Company	5,725	2,002[d]
Cumberland Gas and Electric Company	54,691	23,173
Windsor Electric Company	2,369	236
Total	$277,219	$186,027

[d] Deficit.

Maintenance and Depreciation.—In 1932 maintenance and depreciation of the gas properties of the four companies amounted to 3.82% of the original cost, of which 1.93% was maintenance and 1.89% depreciation. There was considerable variation among the companies in the maintenance and depreciation percentages (see Exhibit 13).

EXHIBIT 13
RATIOS OF DEPRECIATION AND MAINTENANCE CHARGES IN 1932 TO ORIGINAL COST OF PLANT

Company	Maintenance, per cent	Depreciation, per cent	Total, per cent
Thornton Gas Light Company	2.02	1.90	3 92
Lincoln Gas and Electric Company	1.52	1.60	3 12
Cumberland Gas and Electric Company	1.90	1.93	3 83
Windsor Electric Company	1.82	2.64	4 46
All companies	1.93	1.89	3 82

Franchises.—One of the four companies was incorporated in 1895, and the others were established a number of years before this date. The franchises and charters are all of the perpetual type.

Rates.—The domestic gas rate schedules show little variation among three of the companies, but the rates of the Windsor Electric Company are considerably higher than those of the others. In the case of general heating and commercial and industrial rates, the Cumberland Gas and Electric Company charges comparatively low rates and the Windsor Electric Company relatively high rates (see Exhibit 14).

EXHIBIT 14
SCHEDULE OF RATES

Company	Ordinary domestic, first 2,000 cu. ft. per month	General heating, first 10,000 cu. ft. per month	Commercial and industrial, first 50,000 cu. ft. per month
Cumberland Gas and Electric Company	$2 93	$ 8 55	$36.50
Thornton Gas Light Company	2.90	9 69	60.60
Lincoln Gas and Electric Company	2.90	9 69	60.60
Windsor Electric Company	4.28	11.70	78 98

After a careful survey of the properties under consideration, the officers of Barrett, Brooks & Company were convinced that options should be secured if fair prices could be negotiated. It was their opinion that under a single competent management the net income from these properties could be considerably increased as a result of (1) the economies to be gained from consolidation and (2) a more intensive exploitation of the market for gas. If the consolidation was effected, Barrett, Brooks & Company proposed to form an entirely new company, of which it would retain control at least for a time. The new company would purchase for cash, obtained from the sale of securities to the public, the gas properties and franchises under consideration, as well as the accounts receivable from gas customers. In the case of the Thornton Gas Light Company some plan for an exchange of securities might be worked out since it had no electric business. It would also be desirable to sell enough additional securities to provide any further working capital that might be required.

1. Did sound economic reasons for combining these gas properties exist, or was the transaction planned only to gain investment bankers' commissions by the transfer of ownership?

2. Assuming that options were secured and the properties purchased in the spring of 1934 for $10,500,000, plus $500,000 for current assets, present a financial plan for the new company showing (*a*) the types and amount of securities to be authorized and issued, (*b*) the prices at which the securities should be offered, and (*c*) the amount of the profit going to the banking firm and the method of securing this profit.

II

RAISING CAPITAL

1. SHAWVER STEEL COMPANY[1]

FINANCING ADDITIONAL PLANT

The Shawver Steel Company in 1928 required approximately $3,900,000 for additional plant to fill the growing demand for steel in its territory as well as to diversify its products and reduce its operating expenses. A number of plans were submitted to the directors, two of which were studied with particular care. Plan A proposed that the outstanding first mortgage bonds be retired and that $5,850,000 of debenture bonds and $650,000 of 7% preferred stock be sold. Plan B suggested the sale of $2,600,000 of additional Series B mortgage bonds and $1,625,000 of 7% preferred stock.

For 40 years the Shawver Steel Company had operated in the Southwest, where there was an adequate supply of labor, ample room for expansion, and excellent railway transportation; the proposed deepening of the near-by river might make water transportation available. The industries of the surrounding territory were principally agriculture, including cattle raising and meat packing, and the production of oil, natural gas, and minerals.

Since its nearest competitors were in Colorado and Missouri, the Shawver Steel Company had a wide market which it could serve advantageously. Available natural gas from Oklahoma and Texas had reduced operating costs materially. Although there were limestone deposits within 10 miles, the company until 1928 had purchased limestone obtained as a by-product by a quarry operating 520 miles away. A large part of the Shawver Steel Company's raw materials was scrap steel, the local supply of which was equal to many times the company's requirements, as a survey had shown.

The reports of the two engineers who had studied the proposed development showed that the consumption of steel in the

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

West and Southwest had expanded rapidly in recent years. The extensive highway development in that territory required approximately 10 tons of steel a mile. Agriculture used 10½% of the total production of steel in the United States in 1927, oil, gas, water, and mining industries, 8½%, and construction, 22%; all these were important industries in the rapidly growing southwestern territory.

Although before the World War a large amount of pig iron was thought necessary in the manufacture of high-grade steel, during and after the war some of the highest grade steel, such as

Exhibit 1
Shawver Steel Company
Income Statement, Years Ended December 31

Item	1926	1927
Net sales	$7,849,478	$7,880,587
Cost of sales	6,329,349	6,321,467
Gross profit on sales	$1,520,129	$1,559,120
Other income	30,775	25,505
Gross manufacturing profit	$1,550,904	$1,584,625
Selling, general, and administrative expenses	289,549	347,625
	$1,261,355	$1,237,000
Interest and discount charges (net)	153,280	139,373
Net profit	$1,108,075	$1,097,627
Reserves and adjustments	304,412	234,593
Balance for dividends	$ 803,663	$ 863,034
Preferred dividends	113,750	113,750
Common dividends	195,000	243,750
Surplus	$ 494,913	$ 505,534

that used in the manufacture of shells, razors, and fine cutlery, had been made entirely from scrap steel. The per capita consumption of steel in the United States had increased from less than 100 lb. a year in 1890 to 835 lb. in 1925.

While the total steel-ingot production of the United States declined about 8% in 1926, the Shawver Steel Company's ingot production increased 7%. Earnings in 1927 of most steel companies, including the United States Steel Corporation, the Jones-Laughlin Steel Corporation, the Inland Steel Company, the Bethlehem Steel Corporation, and many others, declined, but 1927

earnings of the Shawver Steel Company available for dividends were 7.4% more than in 1926 and 45.7% more than in 1925. Since the existing management, which also owned a controlling

EXHIBIT 2
SHAWVER STEEL COMPANY
EARNINGS SUMMARY, YEARS ENDED DECEMBER 31

Item	1923	1924	1925	1926	1927
Sales	$4,826,692	$5,229,059	$6,744,371	$7,849,478	$7,880,587
Earnings available for interest, income tax reserves, and depreciation	466,253*	516,340*	960,206*	1,270,279	1,344,030
Earnings available, after depreciation, for interest and income tax reserves	312,607*	359,268*	773,916*	1,071,815	1,132,643
Earnings available for dividends after all charges and income tax reserves	216,875*	253,292*	592,323*	803,663	863,034
Tonnage	74,238	94,224	120,791	139,406	149,005

* Adjusted for management compensation contract cancelled in 1925.

EXHIBIT 3
SHAWVER STEEL COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1924	1925	1926	1927
ASSETS				
Property, Plant and Equipment, Less Depreciation	$3,547,083	$5,004,617	$5,131,713	$5,245,534
Accounts and Bills Receivable, Less Reserves	716,523	700,281	1,200,056	762,888
Marketable Securities	......	......	......	713,700
Cash	152,823	75,192	56,188	81,801
Inventories	687,881	947,656	962,913	1,109,057
Deferred	114,800	166,518	145,005	164,372
Total Assets	$5,219,110	$6,894,264	$7,495,875	$8,077,352
LIABILITIES				
Accounts and Wages Payable	$ 202,129	$ 259,277	$ 286,948	$ 376,645
Other Liabilities	44,914	55,510	55,549	68,096
Reserves	88,245	145,675	276,663	302,362
Funded Debt	1,625,000	1,950,000	1,898,000	1,846,000
Preferred Stock	520,000	1,625,000	1,625,000	1,625,000
Common Stock and Surplus	2,738,822	2,858,802	3,353,715	3,859,249
Total Liabilities	$5,219,110	$6,894,264	$7,495,875	$8,077,352

stock interest, had taken charge in 1923, the earnings trend of the company, which always had been good, had improved markedly (see Exhibits 1, 2, and 3).

The capitalization was $1,846,000 of first mortgage refunding 6½% bonds, of which $65,000 was due in 1928, 1929, and

1930; $78,000 in 1931 and 1932; $84,500 in 1933 and 1934; $97,500 in 1935 and 1936; $110,500 in 1937 and 1938; and $910,000 in 1939. The bonds were subject to call in whole or in part on any interest date on four weeks' notice at 102.5 if redeemed within four years before maturity, after which time limit the premium declined one-half of 1% annually. There was $3,250,000 of 7% cumulative $100-par preferred stock authorized, of which $1,625,000 was outstanding. It was callable at 105 on any dividend date at 60 days' notice. There were 97,500 shares of no-par-value common stock outstanding of an authorized amount of 130,780. A regular dividend of $2 annually was paid on the common stock in 1926 and the same amount plus a 50-cent extra in 1927. The cost of the proposed plants and of the retirement of the bonds and preferred stock is given in Exhibit 4.

EXHIBIT 4
SHAWVER STEEL COMPANY
CASH REQUIRED FOR THE PROPOSED FINANCING

Plant additions:	
Wire mill	$2,210,000
Open-hearth furnace	650,000
Bolt and nut works	390,000
Other improvements	351,000
Miscellaneous	227,500
Total cost if bonds and preferred stock were not retired	$3,828,500
Retirement of bonds:	
$1,846,000 first 6½s at 102½	1,892,150
Total cost for plant additions and retirement of bonds	$5,720,650
Retirement of preferred stock:	
$1,625,000 7% cumulative at 105	1,706,250
Total cost for plant additions and retirement of bonds and preferred stock	$7,426,900

The two plans which were seriously considered are given in Exhibits 5 and 6, respectively. Plan A proposed the sale of $5,850,000 of debenture bonds at 92½, the sale of $650,000 of 7% preferred stock at 96, and the retirement of outstanding mortgage bonds. The common stock authorization was to be increased to 260,000 shares, and a 100% stock dividend was to be declared. Bond purchasers also were to receive common stock warrants. Since it seemed evident that bonds would be sold to provide necessary capital, a study of several steel companies' bond issues was made (see Exhibit 7).

EXHIBIT 5
SHAWVER STEEL COMPANY
PLAN A FOR FINANCING ADDITIONS TO THE PLANT

Sale of $5,850,000 5½% debenture bonds at 92½, to net	$5,411,250
Sale of $650,000 7% preferred stock at 96, to net	624,000
Total from sale of securities	$6,035,250
Cost of calling $1,846,000 mortgage bonds at 102.5	1,892,150
Proposed additions to plant	3,828,500
Surplus cash	$ 314,600

New capitalization of 260,000 no-par-value common shares; old common shareholders to receive 2 new for each 1 held, and 58,500 shares to be reserved for exercise of warrants.

With each bond were to be 10 warrants permitting the purchase of common stock from February 1, 1929, through February 1, 1933, at the following prices:

1929	$25
1930	30
1931	40
1932	45
1933	50

Capitalization under Plan A	Authorized	Issued
Debenture bonds, 15-year, 5½% due February 1, 1943	$13,000,000	$5,850,000
Preferred stock, 7% cumulative, $100 par callable at 105	3,250,000	2,275,000
Common stock, no par	260,000 shares	195,000 shares

EXHIBIT 6
SHAWVER STEEL COMPANY
PLAN B FOR FINANCING ADDITIONS TO THE PLANT

Sale of $2,600,000 5½% mortgage bonds at 95½, to net	$2,483,000
Sale of $1,625,000 7% preferred stock at 96, to net	1,560,000
Total from sale of securities	$4,043,000
Proposed additions to plant	3,828,500
Surplus cash	$ 214,500

Capitalization under Plan B	Authorized	Issued
First mortgage bonds:		
Series A refunding 6½% bonds due serially to 1939	$ 1,950,000	$1,846,000
Series B 5½% bonds due 1948	4,550,000	2,600,000
Preferred stock 7% cumulative $100 par	13,000,000	3,250,000
Common stock, no par	260,000 shares	97,500 shares

By Plan B $2,600,000 of Series B 5½% first mortgage bonds and $1,625,000 of 7% preferred stock were to be sold; these sales would provide $214,500 in cash in excess of the estimated cost of the new construction. The authorized common stock was to be increased to 260,000 shares, but no additional stock was to be issued immediately.

EXHIBIT 7
COMPARATIVE ANALYSIS OF REPRESENTATIVE STEEL COMPANY BONDS

Bond	Price	Yield	1927 earnings times interest	5-year earnings times interest	Total net tangible assets per $1,000 bond	Fixed assets per $1,000 bond
American Rolling Mill Debenture 5½s of 1948	99.50	5.02 %	3.38	3.1	$2,850	$2,266
Gulf States Steel Debenture 5½s of 1942	93.75	5.73	3.00	4.1	5,300	3,750
Interstate Iron & Steel First Mortgage 5½s of 1946	98.00	5.55	4.00	4.5	3,449	2,966
Pittsburgh Screw & Bolt Debenture 5½s of 1947	99.00	5.54	7.45*	5.2	2,287	1,220
Sharon Steel Hoop First Mortgage 5½s of 1948	100.50	5.46	3.25	3.82	3,507	2,350

* Estimated.

The Shawver Steel Company made 52 different products in not less than carload lots. Its products included open-hearth, merchant, and billet reinforcing bars, rail-steel reinforcing bars, blue-annealed steel sheets, steel and wrought-iron forgings, machine and carriage bolts, rivets, track spikes, and pressed nuts. The most important plants of the Shawver Steel Company had been built in 1922, 1925, and 1926. The proposed new plants were part of the expansion program outlined by the management and consultant engineers when the former first had assumed control. The additions were to include a wire mill, a combination rod and bar mill, another open-hearth furnace, and additions to the bolt and nut department. Upon completion of the new facilities the Shawver Steel Company would employ 2,600 operators compared with the existing 1,690 and would have an annual productive capacity of 260,000 tons compared with existing capacity of 162,500 tons.

Which of the proposed plans should have been adopted? Should the preferred stock have been retired?

2. MONTGOMERY WARD & CO., INC. SEARS, ROEBUCK AND COMPANY

FINANCING CAPITAL REQUIREMENTS DURING PERIOD OF RAPID EXPANSION

Established in Chicago in 1872, the firm of Montgomery Ward & Co., Inc., initiated the first successful mail-order business in the United States. Based upon the idea of offering a wide variety of articles to the rural population at prices under those quoted by the small local stores, the mail-order business almost immediately prospered. The company solicited customers through the medium of catalogues and secured its merchandise in large quantities directly from manufacturers.

Sears, Roebuck and Company, the largest competing mail-order house, was not organized until 1895 but soon passed the older company in volume of sales. Both these institutions stressed the appeal of economy, and goodwill was created by their policy of strict adherence to a guarantee refunding money for any article which did not correspond in every detail to the description in the catalogues or which was not satisfactory to the customer. The expansion in sales of these leading mail-order houses is shown in the following table:

SALES

Year	Montgomery Ward & Co., Inc.	Sears, Roebuck and Company
1913	$ 39,700,000	$ 91,600,000
1916	62,000,000	146,000,000
1926	183,800,000	247,000,000

After the depression of 1920–1921, the entire field of retail merchandising underwent a change. Previously the mail-order business in the United States had grown to large proportions primarily because of the remoteness of the rural population from trading centers and from representative retail establishments. In this period, however, improvement in means of communication and transportation brought rural residents in closer contact with the outside world. Through motion pictures and greater circulation of newspapers and fashion magazines in rural sections, as

well as through more frequent trips to cities, rural buyers were being educated to look for style in their selection of merchandise. The importance of style and the opportunity for inspection of merchandise at the time of purchase far outweighed the convenience of ordering by mail. Furthermore, mail-order companies could not compete with the large department stores on a style basis because of the length of time required for the preparation of a catalogue after the merchandise had been purchased; during this time a new style would be coming into vogue.

In addition to the change in buying habits and motives which influenced the demand for style merchandise from mail-order houses, the actual decrease in farm population tended to retard the growth of mail-order sales. Farm population in January, 1928, was 27,699,000 in contrast to 32,076,960 in 1910.

In view of these conditions, Montgomery Ward & Co., Inc., and Sears, Roebuck and Company decided to enter the chain department-store field as the most logical step not only in the expansion of their merchandising business, but also in meeting the competition of the city store with its advantages in selling style merchandise. Both institutions could use their large buying departments and branch warehouses in connection with the new enterprise and could take advantage of the goodwill built up over many years.

However, in carrying out a program of expansion the two companies pursued different policies. Early in 1925, Sears, Roebuck and Company established its first retail store. The company had had some previous experience with branch-house distribution over a period of 10 years through the operation of branch houses in various parts of the country, the first of which was established in Dallas, Texas, in 1915. In every case the first retail stores were located in cities where the company had established a branch house. Another factor of importance in the location of stores was the choice, during the experimental period, of larger cities where the company hoped to build up a new clientele of urban buyers and at the same time reach the rural buyer at the time of his visit to the city. Sites were selected not in the shopping district but in less expensive locations on the outskirts of the cities where ample parking space could be provided. From the experience gained in operating large department stores, the company expanded further by placing stores in smaller cities.

Sears, Roebuck and Company classified its stores under three types: Class A units situated in the outlying districts of metropolitan centers carried a complete line of the company's merchandise; Class B stores located in communities of less than 150,000 population handled a smaller variety of goods; while Class C stores sold chiefly automobile accessories, hardware, and articles which were in particular demand in their immediate district. The company with but few exceptions did not purchase going concerns. Although the company leased some of its smaller units, it owned the majority of its stores. At the beginning of 1929, Sears, Roebuck and Company had 37 Class A and 155 Class B stores in operation, while in January, 1930, there were 46 Class A stores in 27 states and 269 Class B and C stores located in 40 states.

In August, 1926, more than a year after Sears, Roebuck and Company established its first retail store, Montgomery Ward & Co., Inc., opened, as an experiment, its first retail store. By the end of 1927 about 25 stores were in operation. In 1928 Montgomery Ward & Co., Inc., announced a plan of locating retail chain stores in all towns with a population of from 5,000 to 75,000 and retail department stores in cities of over 75,000 population. Locations for 1,500 stores had been selected, and 250 new stores would be opened each year until the program was completed. In 1928 and 1929 a total of 532 stores was opened. By 1930, however, the plan was revised and expansion proceeded in a more conservative manner. The following tabulation accounts for 308 of the stores in operation in the summer of 1929 and shows the extent of the distributive system. Each central warehouse dispatched goods to the various retail outlets.

Territory served	Location of central warehouse	Number of stores in operation June, 1929
Great Lakes region	Chicago, Illinois	102
Middle Atlantic states	Baltimore, Maryland	54
Central Middle West	Kansas City, Missouri	34
Central Northwestern states	St. Paul, Minnesota	25
Central Pacific coast	Oakland, California	34
Pacific Northwest	Portland, Oregon	24
Southwestern states	Fort Worth, Texas	20
New England and Northeast	Albany, New York	10
Rocky Mountain section	Denver, Colorado	5

This company concentrated its store expansion in the sma towns of rural districts where it could derive the greatest benefi from the goodwill built up as the result of its mail-order business In contrast to the policy of Sears, Roebuck and Company c ownership of land and buildings, Montgomery Ward & Co Inc., customarily leased its buildings for a two- to five-yea period.

For both companies, entrance into chain department-stor distribution created a need for additional fixed and workin capital. The amount of capital raised and the methods chose for financing the increase in plant, inventories, and receivable can be ascertained by analyzing the financial data in the accom panying exhibits.

From an analysis of the financial data given, be prepare to outline and to discuss the financial policies pursued by Sears Roebuck and Company and Montgomery Ward & Co., Inc. from 1925 to 1930.

Exhibit 1
Sears, Roebuck and Company
Growth of Common Stock Structure

Date	Item	Shares	Stated value
Dec. 31, 1925....	Outstanding, par $100	1,005,000	$100,500,000
1926....	Sale of treasury stock	45,000	4,500,000
		1,050,000	$105,000,000
Dec. 31, 1926....	After 4 for 1 split, and change to no par value	4,200,000	$105,000,000
1928....	Stock dividends, 2%	84,418	2,110,450
1929....	Stock dividends, 4%	174,797	4,369,925
	Issued in acquisition of other companies	31,982	799,550*
	Sold to employees†	46,457	1,161,425*
1930....	Stock dividends, 4%	184,461	4,611,525
	Issued in acquisition of other companies	24,250	606,250*
	Sold to employees	1,608	40,200*
1931....	Stock dividends, 2%	95,692	2,392,300
	Sold to employees	76,865	1,921,625*
1932....	Sold to employees	19,346	483,650*
	Less: Treasury stock	−9,812	−245,300
	Less: Held by trustee for sale to employees	−150,000	−3,750,000
Jan. 28, 1933....	Net outstanding	4,780,064	$119,501,600

* Stock sold to employees or issued for acquisition of other companies was at various prices between $25 and $100, the excess over $25 being applied to capital surplus.

† "Sold to employees" includes stock transferred to trustee for that purpose.

Sources: Company reports and New York Stock Exchange listing applications. Stock dividends are correct as shown in reports. Amounts issued in acquisition of new companies have been taken from the listing applications. Balance has been treated as "Sold to employees."

EXHIBIT 2
SEARS, ROEBUCK AND COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1925	1926	1927	1928	1929	Jan. 28 1933
ASSETS						
Cash	$ 8,547,389	$ 17,437,713	$ 5,578,146	$ 6,107,237	$ 7,089,501	$ 7,630,158
Marketable Securities	1,878,376	13,648,066	22,621,098	11,440,195	17,990,084	5,518,539
Accounts Receivable, Less Reserves	19,145,132	10,076,721	11,732,197	14,913,979	26,145,679	20,097,499
Purchase Money Mortgage Notes*	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000
Inventories	49,724,059	42,556,300	49,644,256	67,269,306	77,937,239	49,084,896
Total Current Assets	$ 91,294,956	$ 95,718,800	$101,575,697	$111,730,717	$141,162,503	$ 94,331,092
Purchases by Employees of Company's Stock					4,636,085	
Investments	6,027,654	5,203,298	2,822,556	3,513,632	4,448,624	8,223,207
Real Estate, Buildings, Fixtures, and Machinery	37,389,727	44,505,734	56,633,565	76,219,729	87,765,377	78,398,384
Goodwill, Patents, etc.	30,000,000	25,000,000	20,000,000	15,000,000	10,000,000	10,000,000
Deferred Assets	3,270,285	3,338,425	3,708,635	2,818,158	3,828,737	2,941,760
Mortgages Receivable						10,612,407
Advances to Rosenwald Estate*						515,439
Stock Purchase Account, Rosenwald Estate*						4,000,000
Plates, Drawings, Cuts—Encyclopedia Britannica						1,823,467
Total Assets	$167,982,622	$173,766,257	$184,740,453	$209,282,236	$251,841,326	$210,845,756

Exhibit 2 (*Continued*)
Sears, Roebuck and Company
Consolidated Balance Sheet, as of December 31

Item	1925	1926	1927	1928	1929	Jan. 28 1933
Liabilities						
Notes Payable	....	....	....	$ 13,500,000	$ 30,798,000	$ 26,017,251
Purchase Money Mortgages	....	....	....	....	1,018,172	
Accounts Payable	$ 18,437,085	$ 13,717,008	$ 16,267,034	15,936,107	18,453,039	6,315,973
Accrued Items	4,477,862	4,461,865	5,015,989	5,028,138	5,012,512	2,844,166
Preferred Stock Not Yet Presented for Redemption	51,231	38,140	25,301	25,301	25,301	
Total Current Liabilities	$ 22,966,178	$ 18,217,013	$ 21,308,324	$ 34,489,546	$ 55,307,024	$ 35,177,390
Encyclopedia Britannica Bonds	....	....	... .	....	....	99,000
Reserves	3,107,777	4,682,054	3,042,047	3,020,616	3,896,356	6,540,678
Stock Dividends Payable	....	....	... ...	2,152,950		
Common Capital Stock, No Par Value	100,500,000	105,000,000	105,000,000	107,110,450	113,441,350	119,501,600
Surplus	41,408,667	45,867,190	55,390,082	62,508,674	79,196,596	49,527,088
Total Liabilities	$167,982,622	$173,766,257	$184,740,453	$209,282,236	$251,841,326	$210,845,756

* These three items arose from certain transactions in 1921 between Mr. Julius Rosenwald, then president of the company, and the company, and from later transactions with the estate of Mr. Rosenwald after his death in 1932.

The $12,000,000 purchase money mortgage notes may be exchanged with the estate at any time before 1951 for real estate which Mr. Rosenwald purchased from the company in 1921 for $16,000,000.

The company also purchased from the estate 188,235 shares of the company's stock at $21.25 per share (market price at date of contract) for $4,000,000, with an option to the estate to repurchase at same price on or before December 31, 1936.

The company also agreed to lend the estate $1,000,000 if requested, and also to assume not over one-half the loss to the estate caused by Mr. Rosenwald's guaranty of certain employees' accounts in 1929, this agreement not to involve more than $1,000,000, which stood as a contingent liability in addition to the actual liabilities shown on the balance sheet.

Source: Company reports.

Exhibit 3
Sears, Roebuck and Company
Consolidated Income and Surplus Account, Years Ended December 31

Item	1926	1927	1928	1929	Dec. 31, 1931 to Jan. 28, 1933
Income Account					
Gross sales	$272,699,314	$292,927,257	$346,973,915	$443,452,640	$295,722,845
Less: Returns, allowances, discounts	24,148,972	24,195,463	27,200,128	39,980,632	24,633,746
Net sales	$248,550,342	$268,731,794	$319,773,787	$403,472,008	$271,089,099
Other income	9,662,409	8,770,593	8,986,527	11,907,979	3,618,552
	$258,212,751	$277,502,387	$328,760,314	$415,379,987	$274,707,651
Less:					
Purchases and expenses	226,268,067	242,334,859	289,809,473	372,661,523	270,514,349
Repairs	1,178,860	1,031,056	1,417,903	1,527,427	1,039,324
Depreciation	2,214,246	2,593,562	4,003,171	4,711,380	5,697,629
	$229,661,173	$245,959,477	$295,230,547	$378,900,330	$277,251,302
Net profit from operations	28,551,578	31,542,910	33,529,767	36,479,657	2,543,651[d]
Less:					
Reserve for taxes	4,461,865	4,187,311	4,412,198	4,193,586	
Company's contribution to employees' fund	2,181,593	2,333,046	2,209,667	2,228,419	
	$ 6,643,458	$ 6,520,357	$ 6,621,865	$ 6,422,005	
Net income for year	21,908,120	25,022,553	26,907,902	30,057,652	$ 2,543,651[d]
Surplus Account					
Balance, January 1	$ 41,408,667	$ 45,867,190	$ 55,390,082	$ 62,508,674	$ 75,037,677
Net income for year	21,908,120	25,022,553	26,907,902	30,057,652	2,543,651[d]
	$ 63,316,787	$ 70,889,743	$ 82,297,984	$ 92,566,326	$ 72,494,026
Less:					
Cash dividends	9,449,597	10,499,661	10,525,910	10,924,901	6,147,463
Stock dividends	...	...	4,263,400*	2,216,975	
Reserves	3,000,000	...	...	...	12,336,236
Reduction of goodwill	5,000,000	5,000,000	5,000,000	227,854†	
Payment to Rosenwald estate	...	...	...	...	750,000
Adjustments of employees' stock subscription plan	...	...	...	...	3,733,239
	$ 17,449,597	$ 15,499,661	$ 19,789,310	$ 13,369,730	$ 22,966,938
Balance, December 31	45,867,190	55,390,082	62,508,674	79,196,596	49,527,088

* About half of this was paid in 1929 but charged in 1928.
† Balance of $5,000,000 reduction was met by premium on stock sales to employees.
[d] Deficit.
Source: Company reports

Exhibit 4
Sears, Roebuck and Company
Common Stock Dividend Record

On $100 par value stock:
- Cash: 1909 to 1921, at varying rates; also various stock dividends.
- Cash: Aug. 1, 1924, to Feb. 1, 1926, inclusive, quarterly at rate of 6% per year.

On no-par-value stock:
- Cash: May 1, 1926, to May 2, 1932, inclusive, quarterly at rate of $2.50 per year.
- Stock: Aug. 1, 1928, to May 1, 1931, inclusive, quarterly at rate of 4% per year.

Source: Moody's *Industrials*, 1933.

Exhibit 5
Sears, Roebuck and Company
Market Price of Common Stock

Year	Low	High
1926	44¼	58⅜
1927	51	91½
1928	82⅛	197½
1929	80	181
1930	43⅛	100⅝
1931	30¼	63¼
1932	9⅞	37⅜

Source: Moody's *Industrials*, 1933.

EXHIBIT 6
MONTGOMERY WARD & CO., INC.
BALANCE SHEET, AS OF DECEMBER 31

Item	1925	1926	1927	1928	1929	Jan. 31, 1933 (consolidated)
ASSETS						
Cash	$ 5,476,213	$10,148,509	$12,192,774	$ 13,942,738	$ 37,492,165	$ 9,300,907
Marketable Securities	397,187	369,567	669,710	596,147	311,048	18,523,060
Accounts Receivable, Less Reserve	5,674,994	7,066,618	9,550,557	17,005,828	22,401,704	14,886,842
Notes Receivable	95,221					
Inventories	34,699,569	28,951,255	31,516,766	59,762,945	67,145,034	40,749,557
Notes Receivable—Affiliated Companies	50,000					
Prepaid Items	....	2,274,502	1,681,181	1,889,911	1,869,775	2,632,046
Total Current and Working Assets	$46,393,184	$48,810,451	$55,610,988	$ 93,197,569	$129,219,726	$ 86,092,412
First Mortgage Notes on Homes Sold	....	....	....	....	....	10,628,930
Employees' Investment and Savings Plans	....	....	1,279,305	1,261,934	5,996,189	
Investments in Affiliated Companies	2,152,864	1,768,779	1,594,782	1,472,704	606,886	493,838
Sinking Fund Deposit Preferred Stock	1,223,849					
Equities in Subsidiary Property Corporations*	3,311,260	5,731,358	6,086,912	17,099,637	22,992,555	
Land and Buildings, Less Depreciation	11,703,771	6,564,570	6,255,652	7,310,105	6,776,039	43,287,843
Machinery and Equipment, Less Depreciation	3,953,318	4,046,463	3,836,110	7,291,678	14,235,523	
Retail Store Leasehold, Improvements, etc., Less Amortization	....	....	....	2,981,577	7,784,775	1,052,934
Total Assets	$68,738,246	$66,921,621	$74,663,749	$130,615,204	$187,611,693	$141,555,957

EXHIBIT 6 (*Continued*)
MONTGOMERY WARD & CO., INC.
BALANCE SHEET, AS OF DECEMBER 31

Item	1925	1926	1927	1928	1929	Jan. 31, 1933 (consolidated)
LIABILITIES						
Notes Payable						
Accounts Payable	$ 6,803,230	$ 4,825,208	$ 5,423,834	$ 11,543,531	$ 6,348,747	$ 4,079,442
Due Customers	3,049,405	3,077,771	2,921,656	2,898,712	2,819,324	1,033,325
Accrued Expenses	2,603,083	2,119,057	2,604,961	2,751,550	2,492,604	2,027,628
Total Current Liabilities	$12,455,718	$10,022,036	$10,950,451	$ 17,193,793	$ 11,660,675	$ 7,140,395
Funded Debt	....	....	....	....	....	2,024,000
General Reserves	2,062,011	2,178,339	1,836,755	1,906,910	1,494,208	2,688,577
Preferred Stock, 7% Cumulative, $100 par	4,249,800					
Class A Stock, $7 Cumulative, No Par†	5,594,037	5,594,037				
Common Stock‡	11,412,510	11,412,510	26,196,285	65,916,595	127,663,740	121,232,141
Created Surplus‡	9,189,738	9,189,738				
Earned Surplus	23,774,432	28,524,961	35,680,258	45,597,906	46,793,070	8,470,844
Total Liabilities	$68,738,246	$66,921,621	$74,663,749	$130,615,204	$187,611,693	$141,555,957

* See Exhibit 7 for details.
† 205,000 shares of Class A stock issued and outstanding. On January 31, 1932, 3,446 shares of these were held in treasury. On same date, there were $1,175,731 67 of dividends in arrears on this issue.
‡ In February, 1922, owing to impairment of capital, the no-par common stock was changed to $10 par; this created a surplus of $9,189,738. In February, 1927, the common stock was changed to no par, and the surplus was thereafter lumped with the stated value of the stock.
Source: Company reports.

EXHIBIT 7
MONTGOMERY WARD & CO., INC.
BALANCE SHEETS OF SUBSIDIARIES, AS OF DECEMBER 31

Item	1926	1927	1928	1929
Montgomery Ward Properties Corporation:				
ASSETS				
Land and Buildings, Less Depreciation	$7,696,753	$7,667,127	$10,874,700	$22,992,555
Unamortized Bond Discount and Expense	314,465	294,575		
Total Assets	$8,011,218	$7,961,702	$10,874,700	$22,992,555
LIABILITIES				
Accrued Bond Interest	$ 47,916	$ 46,479		
First Mortgage Gold Bonds, Series A, 5%	5,750,000	5,577,500		
Equity of Montgomery Ward & Co., Inc.				
Current Account	463,302	587,723	$ 9,124,700	$21,242,555
Capital Stock, 17,500 Shares, $100 Par	1,750,000	1,750,000	1,750,000	1,750,000
Total Liabilities	$8,011,218	$7,961,702	$10,874,700	$22,992,555
Montgomery Ward Section C Associates:				
ASSETS				
Land and Buildings, Less Depreciation	$2,798,557	$2,775,840	$ 2,752,009	
Unamortized Note Discount and Expense	26,525	21,743		
Total Assets	$2,825,082	$2,797,583	$ 2,752,009	
LIABILITIES				
Accrued Note Interest	$ 31,338	$ 28,875		
First Mortgage Serial Gold Notes, 5½%	1,468,000	1,350,000		
Preferred Stock of Montgomery Ward Section B	32,000			
Equity of Montgomery Ward & Co., Inc.				
Current Account	1,193,744	1,318,708	$ 2,652,009	
Capital Stock, 1,000 Trust Shares, $100 Par	100,000	100,000	100,000	
Total Liabilities	$2,825,082	$2,797,583	$ 2,752,009	
Montgomery Ward Warehouse Company:				
ASSETS				
Land and Buildings, Less Depreciation	$3,554,354	$3,515,123	$ 3,472,928	
Unamortized Bond Discount and Expense	38,520	31,858		
Total Assets	$3,592,874	$3,546,981	$ 3,472,928	
LIABILITIES				
Accrued Bond Interest	$ 18,562	$ 16,500		
First Mortgage Serial Gold Bonds, 5½%	1,350,000	1,200,000		
Equity of Montgomery Ward & Co., Inc.				
Current Account	1,724,312	1,830,481	$ 2,972,928	
Capital Stock, 5,000 Shares, $100 Par	500,000	500,000	500,000	
Total Liabilities	$3,592,874	$3,546,981	$ 3,472,928	
Grand Total Equity in Three Companies	$5,731,358	$6,086,912	$17,099,637	$22,992,555

Source: Company reports.

EXHIBIT 8
MONTGOMERY WARD & CO., INC.
GROWTH OF COMMON STOCK STRUCTURE

Date	Item	Shares	Stated Value
Dec. 31, 1925......	Outstanding	1,141,251	$ 11,412,510
December, 1928 / January, 1929 ..	Sold to stockholders at $17.50 per share, on basis of 2 new shares to each old share	2,269,732	39,720,310
		12,770	223,475
	Sold to employees at $90 per share	41,823	3,764,070
August, 1929....	Sold to stockholders at $50 per share on basis of 1 new share to 3 old shares	1,155,192	57,759,600
1930....	Adjustment of transactions arising out of 1929 Employees' Investment and Savings Plan	−55,764	−4,461,120
1931....	Deduction of treasury stock............	−50,811	−1,309,048
1932....	Deduction of treasury stock	−48,953	− 661,431
Jan. 31, 1933......	Shares outstanding	4,465,240	$106,448,366
	Stated value of 205,000 shares of Class A stock		5,594,037
	Created surplus transferred 1927		9,189,738
	Total stated value of all stock, as per balance sheet		$121,232,141

Source: Company reports.

EXHIBIT 9
MONTGOMERY WARD & CO., INC.
DESCRIPTION OF SUBSIDIARY COMPANIES

MONTGOMERY WARD PROPERTIES CORPORATION (*a Delaware Corporation*)

The mortgage, dated May 1, 1926, covers land and buildings at St. Paul, Portland, and Oakland, having a floor space in excess of 2,425,000 sq. ft. It will also cover all property hereafter acquired by the Properties Corporation. Under date of March 23, 1926, stockholders representing in excess of 75% of each the Preferred and Class A stocks of Montgomery Ward & Co., Inc., gave their consent to eventually transferring to the Properties Corporation under this mortgage the land and buildings located at Chicago, Kansas City, and Baltimore, in addition to those locations enumerated above.

The plants covered by the mortgage are leased to Montgomery Ward & Co., Inc., for a term extending one year beyond the maturity date (1946) of any bonds issued under the mortgage, at a rental sufficient to cover interest and sinking fund payments; the company also assuming all taxes, maintenance, and operating expenses.

Source: Company report for 1926.

The company now owns free and clear of incumbrances, land and buildings at Kansas City, St. Paul, Portland, Oakland, Baltimore, Albany, Denver, Fort Worth, Oklahoma City, Spokane, and Des Moines.

Source: Company report for 1929.

MONTGOMERY WARD SECTION C ASSOCIATES (*a Massachusetts Real Estate Trust*)

Under the mortgage dated February 10, 1925, which covers the land and buildings at Kansas City containing floor space in excess of 1,464,000 sq. ft, $1,500,000 of first mortgage 5½% notes were authorized and issued, maturing serially . . . ending with final maturity February 10, 1936. . . .

The plant at Kansas City is leased to Montgomery Ward & Co., Inc., for a term extending one year beyond the maturity date of the above-mentioned notes at a rental sufficient to cover interest and redemption payments; the company assuming all taxes, maintenance, and operating expenses.

MONTGOMERY WARD WAREHOUSE COMPANY (*a Maryland Corporation*)

The mortgage, dated October 1, 1924, covers the land and buildings at Baltimore with a floor space in excess of 1,245,000 sq. ft. Under this mortgage $1,500,000 of bonds were authorized and issued . . . maturing serially . . . up to . . . October 1, 1935. . . .

The Baltimore plant is leased to Montgomery Ward & Co., Inc., for a term extending one year beyond maturity date of the bonds, at a rental sufficient to cover interest and redemption payments; the company also assuming all taxes, maintenance, and operating expenses.

Source: Company report for 1926.

Exhibit 11
Montgomery Ward & Co., Inc.
Common Stock Dividend Record

On stock issued in 1919 with no-par value, changed to $10 par in 1922, and to no par in 1927:

Nov. 15, 1926, to Nov. 15, 1928, inclusive	Quarterly at rate of $4 per year plus $1 extra Feb. 15, 1928
Feb. 15, 1929, to Aug. 15, 1929, inclusive	Quarterly at rate of $2.50 per year
Nov. 15, 1929, to Aug. 15, 1930, inclusive	Quarterly at rate of $3 per year

N.B. On January 31, 1933, there were $1,175,732 arrears of dividends on Class A stock.

Source: Moody's *Industrials*, 1933.

Exhibit 12
Montgomery Ward & Co., Inc.
Market Price of Common Stock

Year	Low	High
1926	56	82
1927	60⅜	123⅛
1928:		
To Dec 10	117	439⅞
Dec. 10–31 ex rights*	115¼	156½
1929:		
January	134½	156⅞
February	120	145½
March	111⅛	140¾
Apr. 1–July 29	99	132⅞
July 30–Aug. 31 ex rights†	105½	137⅞
September	116	137⅞
October	49½	117½
November	49¼	72
December	42⅝	67
1930	15⅛	49⅞
1931	6⅝	29¼
1932	3½	16

Price of Rights

1928:		
December	115¼	156½
1929:		
July	17⅝	21⅛
August	19⅜	27⅜

* Rights to buy 2 new shares at $17.50 for each old share. Stock traded ex rights from December 11, 1928.

† Rights to buy 1 new share at $50 for each 3 old shares. Stock traded ex rights from July 30, 1929.

3. AMERICAN TELEPHONE AND TELEGRAPH COMPANY THE NORTH AMERICAN COMPANY

FINANCING CAPITAL REQUIREMENTS DURING PERIOD OF CONTINUOUS EXPANSION

In 1885 the American Telephone and Telegraph Company vas incorporated in New York for the purpose of owning and perating the long-distance lines connecting the local companies f the American Bell Telephone Company. The latter company, which at the time of the organization of the American Telephone nd Telegraph Company had bought all its stock, later transerred the stocks of its licensee companies to the new company n order to facilitate the carrying on of the long-distance business. Finally in 1899, because of the restrictive Massachusetts cororation laws, all the remaining assets of the American Bell Telephone Company were transferred to the American Telephone nd Telegraph Company, which then became a holding company or the entire system in addition to owning and operating the longlistance business. By 1932 the company comprised over 30 assoiated companies with consolidated assets of over $4,000,000,000.

As a holding company for the Bell system, the American Telephone and Telegraph Company exercised various functions. Local telephone companies were under contract with the parent ompany for services, such as engineering advice, financial and egal services, and patent protection, which could best be performed y a central organization. Until 1927 the parent company ented the telephone instruments to its operating subsidiaries nder a license agreement. For this service, together with ts other services, it formerly charged the subsidiaries 4½% of heir gross revenues. After 1927 it sold its telephone instruments o the operating companies and reduced its service charges first o 2% and then to 1½% of gross revenues.

Through its ownership of long-distance lines, the company urnished service not only to associated companies but also to ,900 independent companies. The parent company assisted, noreover, in the financing of local extensions by investing in the ecurities of the operating companies or by short-term loans to hem.

The American Telephone and Telegraph Company also owned 98% of the stock in Western Electric Company, Inc., which

manufactured telephone instruments and other equipment for sale to the associated companies and to enterprises outside the system. In 1924 Bell Telephone Laboratories, Inc., owned jointly by the American Telephone and Telegraph Company and Western Electric Company, Inc., was organized to carry on research for improving manufacturing and operating methods.

From the beginning the parent and subsidiary companies were faced continually with the problem of raising new capital to finance the steady expansion of the physical plant necessitated by the increasing demand for telephone service. Over $1,000,000,000 was invested in plant in the years from 1900 to 1919 (see Exhibit 6) whereas in the next decade plant additions averaged nearly a quarter of a billion dollars annually. Only a small part of this expenditure was for long-distance lines of the parent company itself; the greater part was for increasing the plant of operating companies. From the financial data given in the exhibits, the methods by which this growth was financed can be ascertained.

Similar in certain respects to the American Telephone and Telegraph Company was The North American Company, also a holding company in the public utility field. It was incorporated in 1890 as the successor to a holding company with investments largely in steam-railroad securities. The new company soon concentrated, however, on electric light and power companies and electric railways. Its growth was effected both by the purchase of operating companies and by an increase in the physical plant of the companies under the control of the parent company, total consolidated assets of the company in 1932 were over $800,000,000.

The company's major controlled properties were those supplying services in and around the cities of Milwaukee, Cleveland, St. Louis, and Washington. In addition to these properties, the company had substantial but not controlling interest in The Detroit Edison Company, the North American Light & Power Company, and the Pacific Gas and Electric Company. The company also owned extensive coal properties in Illinois and Kentucky.

The accompanying financial data indicate that, although The North American Company and its subsidiaries were compelled to raise new capital at regular intervals, the financial policy pursued by this system differed from that of the American Telephone and Telegraph Company.

1. From a study of the financial data given, be prepared to indicate in detail the methods by which these companies have financed their growth.

2. Compare and contrast their financial policies from (*a*) the point of view of the most effective means for raising capital, and (*b*) the point of view of holders of the securities of these companies.

EXHIBIT I

AMERICAN TELEPHONE AND TELEGRAPH COMPANY (PARENT COMPANY ONLY)

BALANCE SHEET, AS OF DECEMBER 31

(In thousands of dollars)

Item	1900	1910	1920	1923	1926	1929	1932
ASSETS							
Investments:							
Stocks of Associated Telephone Companies		$356,662	$524,446	$ 756,464	$1,173,871	$1,589,327	$1,942,218
Stocks of Other Companies			57,990	102,212	79,900	138,159	169,347
Bonds, Notes, Advances—Associated Companies		54,021	190,549	178,147	217,684	305,784	328,656
Notes and Advances—Other Companies			7,588		9,696	32,499	34,512
Total Investments	$ 93,830	$410,683	$780,573	$1,036,823	$1,481,151	$2,065,769	$2,474,733
Plant and Equipment	22,086	59,702	123,224	171,999	229,475	350,932	455,291
Trustees—Employees' Stock Purchase Plans			738				
Accounts Receivable	5,241	6,093	8,697	10,444	13,737	18,935	11,905
Temporary Investments		628		62,218	91,950	20,592	140,148
Cash	1,078	13,109	26,636	25,218	24,789	20,796	30,491
Total Current Assets	$ 6,319	$ 19,830	$ 35,333	$ 97,880	$ 130,476	$ 60,323	$ 182,544
Total Assets	$122,235	$490,215	$939,868	$1,306,702	$1,841,102	$2,477,024	$3,112,568
LIABILITIES							
Capital Stock Issued	$ 89,101	$263,335	$442,825	$ 735,519	$1,064,328	$1,322,340	$1,866,227
Installments on Stock				17,982	48,469	72,156	13,767
Premiums on Stock		17,000	36,684	41,437	44,885	69,335	268,749
Total Stock	$ 89,101	$280,335	$479,509	$ 794,938	$1,157,682	$1,463,831	$2,148,743
Collateral Trust Bonds		78,000	164,446	161,950	159,536	79,371	66,690
Debentures				100,000	220,934	218,223	364,567
Convertible Bonds		38,941	62,983	17,408	4,480	223,440	15,512
Notes		29,677	90,000	30,468		9,873	14,437
Securities Held by Associated Companies (and Treasury Bonds)		−17,300			240	411	566
Total Funded Debt	$ 10,006	$129,318	$317,429	$ 309,826	$ 385,190	$ 531,318	$ 461,772
Dividends Payable	1,282	5,267	8,852	16,539	23,947	29,753	41,990
Accounts Payable	1,647	594	7,423	7,755	8,906	19,049	16,962
Accrued Items		2,166	6,774	8,169	12,167	17,374	10,772
Total Current Liabilities	$ 2,929	$ 8,027	$ 23,049	$ 32,463	$ 45,020	$ 66,176	$ 69,724
Reserve for Depreciation	2,416	37,425	57,915	75,985	102,099	114,652	64,314
Reserve for Contingencies							64,664
Reserve for Employees' Benefit Fund			2,000	6,000	7,000		
Surplus	1,813	35,110	59,966	87,490	144,111	301,047	303,351
Contingent	15,970						
Total Liabilities	$122,235	$490,215	$939,868	$1,306,702	$1,841,102	$2,477,024	$3,112,568

Source: Company reports.

Exhibit 2
American Telephone and Telegraph Company
Summary of All Stock Issued 1900–1932

	Shares
Shares outstanding January 1, 1900, largely held by American Bell Telephone Company, and later sold to the public from its treasury	235,000
Shares issued in 1900 to stockholders of American Bell Telephone Company, 2 shares for each share of the latter company	517,726
Shares offered to stockholders, 1900–1932, as per Exhibit 3	11,493,204*
Shares sold to employees, 1922–1932	1,834,158†
Shares issued in acquisition of other companies	210,000†
Shares issued for convertible bonds (about half from 1908 to 1924 and half in 1930)	4,372,187†
Shares outstanding December 31, 1932	18,662,275

* Majority of these shares were subscribed for by stockholders; the few remaining shares were sold to the public at a premium.
† Exact division among these three items is not given in earlier reports; the figures are approximate.
Source: Company reports.

Exhibit 3
American Telephone and Telegraph Company
Shares Offered at Par to Stockholders

Year	Shares offered	Shares held to acquire each new share
1900	103,545	5
1901	207,090	3
1902	219,370	4
1903	219,342	5
1907	219,252	6
1911	550,865	5
1916	395,506	10
1921	898,195	5
1922	1,189,152	5
1924	1,511,575	5
1926	1,541,275	6
1928	1,858,630	6
1930	2,579,407	6
Total	11,493,204	

Convertible 4½% Bonds Offered at Par to Stockholders

Year	Par value offered	Shares held to acquire each $100 bond
1913	$ 67,000,000	5
1929	219,112,700	6

Sources: Company reports; New York Stock Exchange listing statements.

EXHIBIT 4

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

PRICE OF COMMON STOCK AND RIGHTS AT SELECTED DATES

Date	Notes	Stock prices		Price of rights, range during period	
		Low	High	Low	High
1926:					
May 19........	d*	141	144⅜		
May 20........		145⅛	147½		
June 7.........		149	149½		
June 8.........	r	143¼	143¾	5¾	6 11/16
June 17...		141⅝	142½		
June 18	x	139⅝	140⅛		
August 2.......		141⅜	143½		
September 18...		146⅞	147		
September 19 ..	x	144	144¾		
December 18...		150½	151		
December 19...	x	148¾	150		
1927:					
March 14.. ...		159	159¼		
March 15......	x	157	157⅝		
June 18.... ..		167⅛	167½		
June 20.... ...	x	164⅛	165⅛		
September 19 .		174¾	176⅞		
September 20...	x	174	175½		
December 19...		181¼	182¾		
December 20 .	x	179	180		
1928:					
March 14......		181½	182⅜		
March 15......	x	179¼	180⅞		
May 16..... .	d†	194½	197		
May 17........		197	211		
May 31........		200¾	204¼		
June 1.........	r	189	190¾	11⅜	14½
June 19........		175	176¾		
June 20...	x	174⅛	176		
August 1.......		174	176⅝		
September 19...		181½	182⅝		
	x	180⅛	181¾		
December 19...		190	192		
December 20...	x	189¼	189⅞		
1929:					
March 13......		214⅜	216⅞		
	x	214¾	216⅜		
March 26......	‡	208	212¼		
March 27......		209	217¼		

d Date of declaration of dividend.
r Date on which stock sold ex rights.
x Date on which stock sold ex dividend.
* May 19, 1926. Dividends declared in advance for the next 4 quarters. Rights to buy 1 new share at par for 6 shares held offered to stockholders of record June 8; rights to expire August 2.
† May 16, 1928. Rights to buy 1 new share at par for 6 shares held offered to stockholders of record June 1; rights to expire August 1.
‡ March 26, 1929. Directors voted to recommend issue of convertible bonds.

EXHIBIT 4 (*Continued*)
AMERICAN TELEPHONE AND TELEGRAPH COMPANY
PRICE OF COMMON STOCK AND RIGHTS AT SELECTED DATES

Date	Notes	Stock prices		Price of rights, range during period	
		Low	High	Low	High
1929:					
April 30........	§	234	234⅞		
May 1.........		228½	232⅝		
May 9.........		222½	225⅜		
May 10.	r	218½	220	3	8
June 19........		215	216½		
June 20........	x	212	214		
September 19...		303¼	310¼		
September 20...	x	298	304¾		
December 19...		217	221½		
December 20...	x	210	217		
1930:					
March 13......		238	240½		
March 14......		237¼	239¼		
April 15........	‖	268	271		
April 16........		258¾	271½		
May 22........		241½	244⅝		
May 23........	r	224½	230½	16	22⅝
June 19........		204¼	211¼		
June 20........	x	204¾	211		
August 1.......		209½	212½		
September 18...		214⅜	216⅛		
	x	209⅛	213½		
December 18. .		178⅛	183		
December 19...	x	177	180		
1931:					
March 12......		195⅛	196⅜		
March 13......	x	192	194½		
June 18........		167¼	169		
June 19........	x	164⅛	166		
September 17...		151	155½		
September 18...	x	145¾	151⅞		
December 17...		115¼	118¾		
December 18...	x	113¼	121⅛		
1932:					
March 10......		131⅝	133⅛		
March 11.. ...	x	128	130¼		
June 18........		83⅞	85¼		
	x	81¼	83½		
September 19...		107½	110⅝		
	x	105⅝	108½		
December 19...		109	109⅛		
December 20...	x	103¼	106		

§ April 30, 1929. Stockholders approved issue of 10-year 4½% convertible bonds; stockholders to have right to subscribe at par for $100 of bonds for 6 shares of stock held.

‖ April 15, 1930. Rights to buy 1 new share at par for 6 shares held offered stockholders of record May 23; rights to expire August 1.

EXHIBIT 5
AMERICAN TELEPHONE AND TELEGRAPH COMPANY (PARENT COMPANY ONLY)
ANNUAL EARNINGS
(In thousands of dollars)

Year	Net income	Dividends paid	Added to reserves	Added to surplus	Earnings and dividends per share on average number of shares outstanding	
					Earnings	Dividends
1900	$ 5,486	$ 4,079	$ 937	$ 470	$10.09	$7.50*
1910	26,856	20,777	3,000	3,079	10.34	8.00
1920	51,821	35,377	8,000	8,444	11.72	8.00
1921	54,003	42,675	3,000	8,328	11.10	8 50
1922	66,170	52,971	5,000	8,199	11.14	9.00
1923	81,692	63,274	3,000	15,418	11.35	9.00
1924	91,046	70,918	3,000	17,128	11.31	9.00
1925	107,405	81,044	6,000	20,361	11 79	9.00
1926	116,990	86,496	4,000	26,494	11.95	9.00
1927	128,615†	97,380	....	31,235	11.76	9.00
1928	143,170	103,821	......	39,349	12.11	9.00
1929	166,190	116,379	.... .	49,811	12.67	9.00
1930	165,545	139,238	....	26,307	10.44	9.00
1931	166,666	163,588	....	3,078	9.05	9.00
1932	145,907	167,955	......	−22,048	7.82	9.00
Total‡ .	$1,962,580	$1,603,028	$80,268	$279,284		

* Dividend rate raised to 8 % in 1906; annual dividends were maintained 1900 to 1920.
† In addition to the net revenue shown, a special dividend of $47,938,865 was received from the Western Electric Company, Inc., in 1927 and was added to surplus.
‡ Including all years from 1900 through 1932.
Source: Company reports.

EXHIBIT 6
BELL SYSTEM
CONSOLIDATED BALANCE SHEET,* AS OF DECEMBER 31
(In thousands of dollars)

Item	1900	1910	1920	1923	1926	1929	1932
ASSETS							
Telephone Plant	$180,700	$611,000	$1,363,827	$1,978,948	$2,783,023	$3,671,100	$4,188,749
General Equipment	6,464	20,988	47,442	59,761	73,842	110,874	96,070
Investments (Including Western Electric Co., Inc.)	11,401	64,766	115,231	150,060	168,708	232,929	303,378
Accounts Receivable	13,644	26,078	66,351	87,000	91,150	142,666	109,128
Temporary Investments				65,962	93,224	22,086	144,479
Cash	3,223	27,549	41,399	58,317	46,689	48,775	59,772
Total Current Assets	$ 16,867	$ 53,627	$ 107,750	$ 211,279	$ 231,063	$ 213,527	$ 313,379
Contracts and Licenses	14,794	2,943					
Total Assets	$230,226	$753,324	$1,634,250	$2,400,048	$3,256,636	$4,228,430	$4,901,576
LIABILITIES							
Common Stock—American Telephone and Telegraph Co.	$ 89,101	$263,335	$ 442,825	$ 753,502	$1,064,328	$1,322,340	$1,866,227
Common Stock—Associated Companies	40,906	81,310	68,669	63,094	89,715	106,340	133,183
Preferred Stock—Associated Companies				74,939	109,660	110,824	97,938
Capital Stock Installments					49,178	72,358	13,767
Premiums on Capital Stock—American Telephone and Telegraph Co		17,000	36,684	41,437	44,885	69,335	268,333
Total Stock	$130,007	$361,645	$ 548,178	$ 932,972	$1,357,766	$1,681,197	$2,379,448
Mortgage Bonds—Associated Companies			213,572	409,025	536,158	559,446	472,503
Collateral Trust Bonds—American Telephone and Telegraph Co.			164,396	161,926	159,536	79,371	66,690
Collateral Trust Bonds—Associated Companies					414	414	381
Debenture Bonds—American Telephone and Telegraph Co				130,443	225,415	222,712	367,156
Debenture Bonds—Associated Companies			37,330	33,859			10,000
Convertible Bonds—American Telephone and Telegraph Co.			80,496	17,407		218,952	12,923
Notes—American Telephone and Telegraph Co.						9,873	14,437
Notes—Associated Companies			90,000			57,772	99,818
Total Funded Debt	$ 44,138	$224,792	$ 585,794	$ 752,660	$ 921,523	$1,148,540	$1,043,908
Notes Payable	7,000	42,567	10,130	248	863	552	569
Accounts Payable	13,583	21,721	73,430	50,891	57,043	93,353	49,911
Accrued Items				62,308	88,824	117,595	117,894
Total Current Liabilities	$ 20,583	$ 64,288	$ 83,560	$ 113,447	$ 146,730	$ 211,500	$ 168,374
Employees' Benefit Funds			9,363	20,553	35,519		
Reserves for Depreciation	35,498	102,599	407,355	580,416	795,098	699,035	820,195
Reserves for Contingencies						81,628	87,912
Surplus						406,530	401,739
Total Liabilities	$230,226	$753,324	$1,634,250	$2,400,048	$3,256,636	$4,228,430	$4,901,576

* Intercompany duplications excluded. Source: Company reports.

EXHIBIT 7

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

INVESTMENT IN STOCKS* OF ASSOCIATED AND OTHER COMPANIES†

(In thousands of dollars)

Item	December 31, 1926		December 31, 1929		December 31, 1932	
	Par value of holdings by American Telephone and Telegraph Company	Percentage of total outstanding	Par value of holdings by American Telephone and Telegraph Company	Percentage of total outstanding	Par value of holdings by American Telephone and Telegraph Company	Percentage of total outstanding
Associated Companies—Common Stocks:						
New England Telephone and Telegraph Co.	$ 68,589	61.99	$ 68,589	61.94	$ 87,094	65.31
Southern New England Telephone Co.	9,336	33.34	11,670	33.34	13,337	33.34
New York Telephone Co.	280,600	100.00	280,600	100.00	371,300	100.00
New Jersey Bell Telephone Co.	....	......	100,395	100.00	120,395	100.00
Bell Telephone Co. of Pennsylvania	80,000	100.00	90,000	100 00	110,000	100 00
Diamond State Telephone Co	....	.. ...	2,500	100.00	5,000	100 00
Chesapeake and Potomac Telephone Co.	13,000	100.00	13,000	100.00	18,000	100.00
Chesapeake and Potomac Telephone Co. of Baltimore	26,824	100.00	26,824	100.00	30,000	100.00
Chesapeake and Potomac Telephone Co. of Virginia	13,200	100.00	13,200	100.00	18,000	100.00
Chesapeake and Potomac Telephone Co. of West Virginia	16,200	100.00	16,200	100.00	16,200	100.00
Southern Bell Telephone and Telegraph Co.	79,999	99.99	124,998	99.99	124,999	99.99
Ohio Bell Telephone Co.	49,999	99.99	99,999	99.99	129,999	99.99
Cincinnati and Suburban Bell Telephone Co.	5,446	29.71	6,535	29 71	8,169	29.72
Michigan Bell Telephone Co.	49,988	99.98	84,988	99.99	109,989	99.99
Indiana Bell Telephone Co.	26,999	99.99	29,999	99.99	32,999	99 99
Wisconsin Telephone Co.	21,750	100.00	28,000	100.00	40,000	100.00
Illinois Bell Telephone Co.	79,214	99.02	109,018	99.11	148,741	99.16
Northwestern Bell Telephone Co.	65,000	100.00	65,000	100.00	75,000	100 00
Southwestern Bell Telephone Co.	100,000	100.00	154,999	99.99	172,999	99.99
Mountain States Telephone and Telegraph Co.	27,990	72.82	27,990	72.82	34,988	72.82
Pacific Telephone and Telegraph Co.	38,139	88.69	79,046	85.00	153,887	85.26

EXHIBIT 7 (*Continued*)

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

INVESTMENT IN STOCKS OF ASSOCIATED AND OTHER COMPANIES

(In thousands of dollars)

Item	December 31, 1926		December 31, 1929		December 31, 1932	
	Par value of holdings by American Telephone and Telegraph Company	Percentage of total outstanding	Par value of holdings by American Telephone and Telegraph Company	Percentage of total outstanding	Par value of holdings by American Telephone and Telegraph Company	Percentage of total outstanding
Associated Companies—Preferred Stocks:						
Ohio Bell Telephone Co	$15,480	54 84	$15,389	54 52		
Pacific Telephone and Telegraph Co.	64,043	78.10	64,043	78.10	$64,096	78.17
Other Companies—Common Stocks:						
Bell Telephone Laboratories, Inc	50	50 00‡	50	50.00‡	50	50.00‡
Bell Telephone Securities Co.	1,000	100.00	1,000	100.00	1,000	100.00
Bell Telephone Co. of Canada.	15,625	31.84	18,750	30.56	18,750	24.35
Central Union Telephone Co.	2,999	99.99				
Cuban American Telephone and Telegraph Co	540	50 00	270	50.00	433	50 00
Western Electric Co., Inc. (No-par Value)	738§	98.34	5,162§	98.34	5,929§	98.82
195 Broadway Corporation	2,100	70 00	2,100	70.00	5,500	100 00
205 Broadway Corporation	2,500	100 00	2,500	100.00		
Eastern Telephone and Telegraph Co. (Canada)	....	......	....	......	75	100.00
Transpacific Communication Co., Ltd.	....	....	....	......	25	100.00
Broadcasting Company of America.	200	100.00				
Other Companies—Preferred Stocks:						
Cuban American Telephone and Telegraph Co.	540	50.00	371	50.00	371	50 00

* All stocks shown in table have voting rights except Ohio Bell Telephone Company preferred.
† Table does not include certain associated companies whose stock is owned by other associated companies.
‡ Other 50 % is owned by Western Electric Company, Inc.
§ Thousands of shares of no-par value.
Source: Company reports.

Exhibit 8

Bell System

Consolidated Income Statement,* Years Ended December 31

(In thousands of dollars)

Year	Gross operating revenues	Net earnings before interest	Interest	Net income	Dividends: Associated companies: Preferred	Dividends: Associated companies: Common	Dividends: American Telephone and Telegraph Company: Common	Added to surplus
1910	$ 165,613	$ 50,995	$11,557	$ 39,438	$ 4,384		$ 20,777	$14,277
1920	449,442	79,509	31,724	47,785	4,623		35,377	7,785
1921	497,088	104,199	36,774	67,425	5,175		42,674	19,576
1922	546,829	124,492	37,869	86,623	7,334		52,971	26,318
1923	601,590	137,376	37,752	99,624	9,154		63,274	27,196
1924	657,589	148,777	41,531	107,246	11,685		70,918	24,643
1925	741,300	182,444	45,941	136,503	$6,962	$ 5,237	81,044	43,260
1926	823,217	204,870	49,809	155,061	7,177	6,941	86,496	54,447
1927	894,699	216,571	50,512	166,059	7,306	7,715	97,380	53,658†
1928	975,427	242,723	51,635	191,088	7,322	8,205	103,822	71,739
1929	1,070,794	276,687	59,582	217,105	7,327	8,518	116,379	84,881
1930	1,103,940	267,874	66,228	201,646	7,318	10,069	139,238	45,021
1931	1,075,757	258,099	64,720	193,379	6,428	10,888	163,588	12,475
1932	956,355	194,471	55,135	139,336	6,426	10,652	167,954	−45,696

* Intercompany duplications excluded.

† In addition to the figures shown here, a special dividend of $47,938,865 from Western Electric Company, Inc., was added to surplus.

Source: Company reports.

EXHIBIT 9
THE NORTH AMERICAN COMPANY (PARENT COMPANY ONLY)
BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1926	1929	1932
ASSETS			
Cash and Call Loans	$ 2,866	$ 3,562	$ 7,487
Notes and Accounts Receivable, Including Subsidiaries	15,666	708	3,005
Total Current Assets	$ 18,532	$ 4,270	$ 10,492
Loans and Advances to Subsidiaries	164	32,007	22,297
Loans and Advances to Others	821	1,700	
Stocks	99,500	132,701	186,770
Bonds	527		
Debt Discount and Expenses	....	....	1,574
Total Assets	$119,544	$170,678	$221,133
LIABILITIES			
Notes Payable	$ 3,513		
Accounts Payable	120	$ 110	$ 31
Accrued Interest	....	....	521
Dividends Payable	455	455	455
Stock Dividends Payable	1,020	1,398	1,874
Due Subsidiaries	5,408	14,439	132
Total Current Liabilities	$ 10,516	$ 16,402	$ 3,013
Dividends Unclaimed	21	21	26
Stock Purchase Certificates	....	23	324
Subsidiaries' and Affiliated Companies' Funds	616	601	835
Funded Debt	....	....	25,000
Reserve for Contingencies	....	....	46,771
Other Reserves	1,144	287	712
Preferred Stock	30,336	30,334	30,334
Common Stock	40,913	56,038	74,986
Capital Surplus	23,822	31,084	
Undivided Profits	12,176	35,888	39,132
Total Liabilities	$119,544	$170,678	$221,133

Source: Moody's *Public Utilities.*

EXHIBIT 10
THE NORTH AMERICAN COMPANY (PARENT COMPANY ONLY)
ANNUAL EARNINGS
(In thousands of dollars)

Year	Operating income after expenses and taxes	Interest	Net income	Preferred dividends	Common* dividends	Other appropriations	Added to undivided profits
1926	$ 8,722	$ 234	$ 8,488	$1,820	$3,933	$ 269	$ 2,466
1927	10,280	307	9,973	1,820	4,342	251	3,560
1928	15,488	1,102	14,386	1,820	4,807	1,701†	9,460
1929	19,128	1,263	17,865	1,820	5,353	....	10,692
1930	18,458	524	17,934	1,820	5,947	472	9,695
1931	19,396	1,413	17,983	1,820	6,559	13,631	−4,027
1932	15,224	1,622	13,602	1,820	7,231	6,973	−2,422

* Paid in common stock.
† Adjustment of surplus of a subsidiary.
Source: Moody's *Public Utilities*.

EXHIBIT 11
THE NORTH AMERICAN COMPANY
SUMMARY OF ALL COMMON STOCK ISSUED, 1921–1932

Shares Outstanding, 1921*...........................	$14,896,650
Shares Sold to Stockholders or Underwriters†...........	10,291,950
Shares Issued for Acquisition of Other Companies‡......	5,745,760
Shares Issued as Stock Dividends......................	44,225,710
Shares Issued for Miscellaneous Purposes...............	149,670
Total Shares Outstanding, December 31, 1932.........	$75,309,740

* In January, 1901, capitalization was reduced to $12,000,000 authorized and $11,936,700 outstanding by the exchange of 3⅓ shares of old stock for 1 share of new. By the end of 1907 stock to the amount of $11,000,000 had been sold to stockholders and nearly $6,000,000 had been issued in acquisition of other companies, making a total of $29,793,300 outstanding. In 1921 one-half of the latter amount with a par value of $100 per share was exchanged for 6% cumulative preferred stock of $50 par value and the remaining half for common stock of $50 par value.

The par value of this stock was changed to $10 by a 5-for-1 split in 1923; in 1927 the common stock was changed to no-par value but with a stated value of $10.

† Shares sold to stockholders or underwriters: 1922, $6,052,600; 1923, $4,233,250; 1929, $6,100.

‡ Par or stated value of shares issued for acquisition of other companies: 1925, $4,748,330; 1928, $288,500; 1929, $708,180; 1931, $750.

EXHIBIT 12
THE NORTH AMERICAN COMPANY
PRICE OF COMMON STOCK AT SELECTED DATES

Date	Notes	Stock prices	
		Low	High
1927:			
February 14	d	47¾	48¾
February 15		48⅜	49¼
March 3		48⅝	49¾
March 4	x	48	48⅞
May 16	d	47⅝	48
May 17		48	48¾
June 5		51	52
June 6	x	50½	51¾
August 15	d	48⅝	49⅛
August 16		49⅛	49½
September 3		56	58⅛
September 6	x	56⅝	58
December 3		62⅛	62½
December 5	x	59⅜	60¾
1928:			
February 17	d	60¼	61⅞
February 18		59½	60⅛
March 3		61⅜	62
March 5	x	59⅝	60⅛
June 4		75⅛	76⅝
June 5	x	73⅛	74⅛
July 16	d	68	68½
July 17		68⅛	68⅞
September 4		75¾	79½
September 5	x	75¾	77⅜
December 4		94	95⅝
December 5	x	90⅛	91½
1929:			
March 4		108	109
March 5	x	101⅜	104⅞
June 3		119	121
	x	118	120⅝
September 4		178	185⅞
September 5		170	178⅞
December 4		96	105¾
December 5	x	99	103⅞
1930:			
March 4		117	121¼
	x	114	118⅞
June 4		125⅝	129
June 5	x	122¼	126
September 4		104¼	106⅞
	x	103⅛	105
December 4		69⅜	71½
December 5	x	65¼	68¾
1931:			
March 4		82⅝	86
	x	83	86
June 4		61¼	66⅜
	x	63¾	65¾
September 3		66¼	67½
	x	65	66
December 3		34⅝	37
	x	34¾	37½
1932:			
March 3		38⅝	39¾
	x	37⅜	39½
June 4		18⅛	20⅛
	x	18⅜	19⅝
September 3		41¼	42¾
	x	39¼	42½
December 3		25	26
	x	25¼	26⅝

d Date of declaration of dividend payable first day of January, April, July, and October.
x Date stock sold ex dividend.

EXHIBIT 13
THE NORTH AMERICAN COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1922	1923	1926	1929	1932
ASSETS					
Cash	$ 4,069	$ 3,710	$ 9,283	$ 10,359	$ 23,747
U. S. Government Securities	4,711	2,639	13,657	6,281	5,939
Notes and Bills Receivable	1,539	2,065	589	1,730	577
Accounts Receivable	7,064	8,203	12,764	16,817	13,930
Materials and Supplies	7,182	8,866	10,793	12,657	9,312
Total Current Assets	$ 24,565	$ 25,483	$ 47,086	$ 47,844	$ 53,505
Prepaid Accounts	158	439	1,426	2,285	1,081
Bond and Note Discount	7,800	9,324	15,166	15,274	14,762
Premium on Investment Securities	2,489				
Cash on Deposit with Trustees	1,839	3,116	2,061	2,188	2,583
Investments	13,201	8,532	40,223	64,670	140,321
Property and Plant	188,860	251,661	575,883	776,498	675,534
Total Assets	$238,912	$298,555	$681,845	$908,759	$887,786
LIABILITIES					
Notes and Bills Payable	$ 3,000	$ 4,147	$ 9,546	$ 2,813	
Accounts Payable	4,755	4,255	5,681	4,919	$ 2,986
Sundry Current Liabilities	1,200	2,075	3,409	5,123	4,721
Total Current Liabilities	$ 8,955	$ 10,477	$ 18,636	$ 12,855	$ 7,707
Accrued Liabilities	3,781	6,545	12,359	18,879	15,624
Dividend Payable in Common Stock	....	661	1,019	1,398	1,874
Reserves, Including Depreciation	29,566	37,912	72,864	113,690	159,451
Funded Debt	....	....	....	....	25,000
Subsidiaries—Funded Debt	114,630	146,166	292,783	368,109	301,732
Subsidiaries—Preferred Stock	22,313	29,110	137,217	169,583	138,034
Subsidiaries—Minority Interests	5,075	5,071	9,749	12,511	15,433
Stock Purchase Certificates	....	....	....	23	
6 % Cumulative Preferred Stock	18,963	19,086	30,336	30,334	30,334
Common Stock	21,086	26,489	40,913	56,038	75,310
Capital Surplus (Premium on Common Stock)	....	....	23,822	28,952	
Surplus	14,543	17,038	42,147	96,387	117,287
Total Liabilities	$238,912	$298,555	$681,845	$908,759	$887,786
Book Value per Common Share (on Basis of New Shares)	$16.92	$16.44	$26.09	$32.38	$25.60

Source: Company reports.

EXHIBIT 14
THE NORTH AMERICAN COMPANY
CONSOLIDATED EARNINGS
(In thousands of dollars)

Year	Gross earnings	Total income	Interest and subsidiary dividends	Depreciation	Net income	Dividends of The North American Company		Miscellaneous appropriation	Surplus	Earnings and dividends per common share	
						Preferred	Common			Earnings	Dividends*
1923	$ 75,465	$27,907	$11,654	$ 6,867	$ 9,386	$1,143	$3,039	$2,709	$ 2,495	$3.47	$1.25
1924	80,117	31,841	13,462	7,796	10,583	1,345	2,816	643	5,779	3.32	1.00
1925	93,029	41,617	18,893	9,428	13,296	1,763	3,224	520	7,789	3.74	1.00
1926	115,851	55,611	26,140	11,908	17,563	1,820	3,933	269	11,541	4.05	1.00
1927	122,167	59,881	28,144	12,482	19,255	1,820	4,342	3,881	9,212	4 06	1 00
1928	135,552	68,690	30,013	14,274	24,403	1,820	4,807	−5,739	23,515	4.68	1.00
1929	147,780	75,882	31,455	15,620	28,807	1,820	5,353	121	21,513	5.03	1.00
1930	133,751	71,374	28,277	14,274	28,823	1,820	5,947	−104	21,160	4.53	1.00
1931	117,922	63,206	25,427	13,506	24,273	1,820	6,559	14,917	977	3.41	1.00
1932	107,412	57,347	26,501	14,430	16,416	1,820	7,231	8,602	−1,237	2.01	1.00

* Paid in common stock at rate of 10 % per year, except in 1923 when 5 % was paid in cash and 7½ % in stock.
Source: Company reports.

EXHIBIT 15

SUBSIDIARIES OF THE NORTH AMERICAN COMPANY, DECEMBER 31, 1931

Companies	Capitalization		Per cent owned by: The North American Company	First subsidiary	Second subsidiary	Third subsidiary
North American Edison Co	1st. pfd.	$ 36,766,000				
	Common	33,089,870	100			
Cleveland Elec. Ill. Co	6 % pfd.	15,281,700				
	Common	51,089,400	...	79		
Milwaukee El. Ry & Lt. Co	1921 pfd.	20,739,579				
	6 % pfd.	4,500,000				
	Common	21,000,000	...	100		
Union El. Lt. & Pr. Co. (Missouri)	6 % pfd.	4,000,000				
	7 % pfd.	9,000,000				
	Common	52,500,000	...	100		
Alton Gas Co	Common	325,000	..	. .	100	
Alton Lt. & Pr. Co	Common	1,100,000	...	...	100	
Cent. Mississippi Val. El. Props	6 % pfd.	750,000				
	Common	97,627	...	. .	100	
Dallas City El. Lt. Co	Common	56,000	...	...	...	100
Fort Madison El. Co	Common	10,000 sh.	...	...	...	100
Keokuk El. Co	6 % pfd.	$ 250,000				
	Common	450,000	..	...	...	100
Cupples Station Lt., Ht. & Pr. Co	Common	1,000,000	...	. .	100	
E. St. Louis & Suburban Co	$5 pfd.	60,000 sh.	...	...	100	
	Common	60,000 sh.	...	...	99	
E. St. Louis & Sub. Ry. Co	Stocks		...	..	..	100
	Bonds		...	...	...	100
E. St. Louis Lt. & Pr. Co	Common	$ 2,400,000	...	...	...	100
E. St. Louis Ry. Co	Common		...	...	...	100
St. Louis & Belleville El. Ry. Co	Common		...	...	...	100
	Bonds		...	...	...	100
St. Louis & E. St. Louis El. Ry. Co	Common		...	...	...	100
	Bonds		...	...	...	100
Mississippi River Power Co	6 % pfd.	8,234,475				
	Common	16,000,000	...	...	99	
St. Charles El. Lt. & Pr. Co	Common	50,000	...	...	100	
St. Louis & Alton Ry. Co	Common	1,000,000	...	...	100	
Union Colliery Co	Common	250,000	...	...	100	
Union El. Lt. & Pr. Co. of Ill	6 % pfd.	8,000,000				
	Common	12,500,000	...	...	100	

EXHIBIT 15 (*Continued*)

SUBSIDIARIES OF THE NORTH AMERICAN COMPANY, DECEMBER 31, 1931

Companies	Capitalization		Per cent owned by: The North American Company	First subsidiary	Second subsidiary	Third subsidiary
Lakeside El. Lt. & Pr. Co.	Common	$ 5,000	...	...	100	
Wisconsin Electric Power Co.	6½ % pfd.	3,492,000				
	6 % pfd.	1,653,291				
	Common	8,000,000	...	100		
Wisconsin Gas & El. Co.	6 % pfd.	4,560,345				
	Common	6,000,000	...	100		
Wisconsin Michigan Power Co.	6 % pfd.	3,908,001				
	Common	5,225,000	...	100		
Western Power Corp.	7 % pfd.	9,654,400				
	Common	8,049,450	99			
Washington Railway and Elec. Co.	5 % pfd.	8,500,000	15			
	Common	6,500,000	95			
Washington & Glen Echo R.R. Co.	Common	200,000	...	98		
Washington & Rockville Ry. of Montgomery County	Common	275,000	...	100		
Braddock Lt. & Pr. Co	Common	50,000	...	...	100	
Washington Interurban R.R. Co.	Common	50,000	...	...	100	
Potomac Electric Power Co.	5½ % pfd.	5,000,000				
	6 % pfd.	2,000,000				
	Common	6,000,000	.	100		
West Kentucky Coal Co.	7 % pfd.	6,000,000	100			
	Common	3,080,000	100			
N. Am. Utility Securities Corp.	7 % pfd.	60,000 sh.	100			
	Common	466,548 sh.	80			
St. Louis County Gas Co.	Common	$ 2,500,000	100			
60 Broadway Building Corp.	Common	5,000 sh.	100			
Investment of North American Company in Public Utilities Other Than Subsidiaries						
Detroit Edison Company	Common	$127,226,000	19			
North American Light and Power Co.	$6 pfd.	19,397,823				
	Common	42,773,975	41			
Pacific Gas and Electric Co.	6 % pfd.	87,606,407				
	5½ % pfd.	26,886,150				
	Common	155,906,357	33			

Source: *Financial and Statistical Handbook* of The North American Subsidiaries, 1931.

4. PIEDMONT CIGARETTE COMPANY

RAISING FUNDS TO FINANCE INCREASE IN SALES

At a meeting of the board of directors of the Piedmont Cigarette Company in January, 1933, Mr. Marshall, the treasurer, expressed his opinion that the company should take immediate steps to increase its working capital by at least $1,000,000 and to raise an additional $150,000 for expansion of fixed assets. Mr. Marshall called attention to the fact that, as a result of the introduction of "Flashes," a 10-cent brand of cigarette, sales had increased by over $12,000,000 in the past year. With this increased volume of business he considered that the company was inadequately financed (see Exhibits 1, 2, and 3).

In support of his position as to the necessity for new funds, Mr. Marshall pointed out that, although December purchases of tobacco had been carried out on a basis normal for preceding years, large purchases of leaf tobacco would have to be made during January and February, the peak of the buying season, even to maintain the 1932 volume of sales. The company always paid cash at the auction sales when the leaf tobacco was purchased, whereas its terms to customers were 2% 10 days, net 60 days. Although most of its trade took advantage of the discount, the Piedmont Cigarette Company not only had to procure approximately a year's supply during the buying season to insure getting a good quality of the tobacco offered but also had to store the tobacco purchased for at least a year in order to age it properly. A further reason for a significant expansion of inventory at this time was the favorable price at which leaf tobacco could be bought (see Exhibit 4). Any rise in the price of the raw product would jeopardize profits since the retail price of cigarettes responded very sluggishly to a change in the price of tobacco. The $150,000 for fixed asset expansion, Mr. Marshall explained, was to provide the company with greater facilities for storing the leaf and for acquiring additional cigarette machinery.

Organized in 1899, the Piedmont Cigarette Company, located in Durham, North Carolina, was conducted for nearly 30 years as a small closed corporation. During this period no national advertising was undertaken and the company's line of cigarettes and pipe tobacco was sold only in Southern cities. For the most part, the company expanded by reinvesting its earnings in excess

of dividends, and under this policy the original capital of less than $100,000 had increased to over $1,000,000 by 1926. The company had always been able to earn for its owners a profit which had been on the average about $250,000 a year from 1924 to 1926.

In December, 1926, the Piedmont Cigarette Company began the manufacture of "Peterboroughs," a high-quality cigarette of distinctive flavor which retailed for 20 cents a package. Although distributed through the company's usual outlets and without the support of national advertising, the new brand was very favorably received. By the end of 1927, in view of the increase in the sale of Peterboroughs by 4,000%, the president of the Piedmont Cigarette Company concluded that the new brand could be made to produce considerable profits if it were advertised and distributed throughout the entire country.

In 1928 the Piedmont Cigarette Company reorganized to provide for a substantial capital expansion. With its capital increased to nearly $3,000,000 by the sale of preferred and common stock, the plant was expanded and a national advertising campaign for Peterboroughs was launched.[1] As indicated in Exhibit 2, the new policy proved a profitable one for the company. In 1931, however, the cigarette industry began to feel the results of the depression (see Exhibit 5). To offset the decreasing demand for the 15- and 20-cent brands of cigarettes, a few companies brought out new brands of cigarettes to retail at 10 cents for a package of 20. Because of the general situation, the demand for Peterboroughs fell off; hence the Piedmont Cigarette Company decided in the spring of 1932 to enter the 10-cent field with the new brand, Flashes.

Mr. Marshall stated to the directors that it was the immediate success of their 10-cent brand which had effected such a large increase of sales for 1932. Despite the fact that the profit margin was considerably less on Flashes, he believed that the 10-cent package was to be a permanent factor in the trade and that, with careful buying and the use of the latest cigarette machinery, a satisfactory profit could be made on this brand. Increased working capital, he asserted, was necessary both for carrying a larger inventory and for financing the cash purchase of revenue stamps since a 6-cent revenue stamp had to be placed on every

[1] Advertising appropriations were. 1928, $150,000; 1929, $250,000; 1930,$ 1,000,000; 1931, $500,000; 1932, $500,000.

package of 20 cigarettes. In the case of the 10-cent brand this sum amounted to over 70% of the manufacturer's price (see Exhibit 6).

1. Did the fact that the Piedmont Cigarette Company considered it advisable to raise new capital indicate a weak or strong condition in January, 1933?

2. Was it expedient for the company to raise $1,000,000 at that time? If so, how should the funds have been raised? In the answer to this question, consideration should be given to the economic and money market conditions in January, 1933, as well as to the credit position and financial needs of the company.

EXHIBIT I
PIEDMONT CIGARETTE COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1927*	1928	1929	1930	1931	1932
ASSETS						
Cash	$ 148,525	$ 11,538	$ 81,253	$ 136,750	$ 168,425	$ 390,380
Accounts Receivable (Net)	190,784	226,394	358,417	387,786	443,835	1,822,839
Inventories	2,019,058	2,322,760	3,273,754	3,262,300	3,770,314	3,614,556
Total Current Assets	$2,358,367	$2,560,692	$3,713,424	$3,786,836	$4,382,574	$5,827,775
Doubtful Accounts Receivable	....	....	....	4,616	4,337	12,784
Deferred Charges	52,996	66,503	43,453	32,574	29,479	18,194
Investments	....	....	....	....	100	100
Trade-marks and Brands	319,649	347,149	348,551	348,907	349,379	350,496
Property, Less Depreciation	532,063	525,760	557,700	638,138	703,531	801,432
Other Assets	40,128					
Total Assets	$3,303,203	$3,500,104	$4,663,128	$4,811,071	$5,469,400	$7,010,781
LIABILITIES						
Notes Payable	....	$ 279,730	$1,092,960	$ 903,760	$1,499,081	$1,713,941
Accounts Payable	$ 132,405	154,030	103,640	58,685	98,131	108,721
Dividends Payable	....	....	60,419	58,783	73,410	137,682
Accrued Expenses	6,375	5,459	73,659	111,257	94,648	249,536
Federal Taxes	107,250	26,223				
Total Current Liabilities	$ 246,030	$ 465,442	$1,330,678	$1,132,485	$1,765,270	$2,209,880
Bonded Debt	....	....	....	17,500	12,101	11,880
Reserve for Cash Discounts	....	....	6,010			
Preferred Stock	1,100,000	1,100,000	1,045,000	985,500	935,000	888,200
Class A Common Stock	550,000	550,000	550,000	550,000	500,500	500,500
Class B Common Stock	1,100,000	1,100,000	1,100,000	1,177,000	1,177,000	1,177,000
Capital Surplus	307,173	284,662	254,377	255,468	136,204	136,204
Earned Surplus			377,063	693,118	943,325	2,087,117
Total Liabilities	$3,303,203	$3,500,104	$4,663,128	$4,811,071	$5,469,400	$7,010,781
Shares of Preferred Stock	11,000	11,000	10,450	9,855	9,350	8,882
Shares of Class A Common Stock	55,000	55,000	55,000	55,000	50,050	50,050
Shares of Class B Common Stock	110,000	110,000	110,000	117,700	117,700	117,700

* After giving effect to 1928 financing.

Exhibit 2
Piedmont Cigarette Company
Earnings Statement, Years Ended December 31

Item	1928	1929	1930	1931	1932
Net sales	$4,369,791	$5,717,901	$6,904,819	$6,922,121	$19,369,571
Less:					
Cost of sales	3,121,857	4,039,633	4,626,357	4,562,973	15,448,044
Selling expense	993,198	956,750	1,244,782	1,495,090	1,974,367
Administration and general expense		122,305	131,710	144,585	191,887
Net profit	$ 254,736	$ 599,213	$ 901,970	$ 719,473	$ 1,755,273
Other income	846	45,534	27,380	38,340	52,910
Total income	$ 255,582	$ 644,747	$ 929,350	$ 757,813	$ 1,808,183
Less:					
Interest	30,685				
Federal taxes	26,223	71,954	110,833	91,706	249,536
Net income*	$ 198,674	$ 572,793	$ 818,517	$ 666,107	$ 1,558,647
Less:					
Preferred dividends	64,912	82,418	61,519	57,387	53,295
Common A dividends	132,000	220,000	176,000	168,520	168,520
Common B dividends	....	....	188,320	188,320	188,320
Balance to surplus	$ 1,762	$ 270,375	$ 392,678	$ 251,880	$ 1,148,512

* Net income for earlier years:

1923	$146,077
1924	125,565
1925	289,082
1926	329,486
1927	728,892

Exhibit 3
Piedmont Cigarette Company
Stock Provisions

6% Cumulative Preferred Stock, Par Value $100; *Authorized,* 25,000 *Shares.*—Entitled to preferential and cumulative dividends, payable quarterly before payment of dividends on any other stock. Preferred as to assets in case of voluntary or involuntary dissolution up to $105 per share plus dividends. Callable in whole or in part on 60 days' notice at $105 per share plus dividends. Sinking fund of 5% of the largest amount of preferred stock theretofore issued is to be set aside annually and used to retire preferred stock.

Entitled to equal voting power share for share with Class B stock in event of default of four quarterly dividends.

Additional preferred stock may not be issued unless net earnings for the next preceding 12 months equal at least twice the dividend requirements on the preferred outstanding and to be issued, and unless further net quick assets equal at least 125% of the preferred stock outstanding and to be issued. No other stock may be created having equal or prior standing, nor may any indebtedness maturing in more than 12 months, nor any mortgage, nor any sale of substantial part of property be effected without consent of at least two-thirds of holders.

Class A Common Stock, Par Value $10; *Authorized,* 60,000 *Shares.*—Entitled to cumulative preferential dividends of $3.20 per share per annum after payment of dividends on 6% preferred stock. After Class B common stock has received $1.60 per share or 7% in stock in any calendar year, all further dividend payments in such year shall be distributed equally between holders of Class A and Class B stocks, each considered as a class. Callable upon 60 days' notice at $60 a share. Convertible share for share into Class B stock at any time.

Class B Common Stock, Par Value $10; *Authorized,* 250,000 *Shares.*—Has sole voting power, except in default of preferred dividends.

Exhibit 4
Tobacco Prices
Price of Leaf Tobacco, Average Warehouse Sales, Kentucky
Average Based on Sales of Past 12 Months
(In dollars per 100 lb.)

Month	1928	1929	1930	1931	1932
January	......	$19.90	$18.58	$13.28	$8.56
February	......	20.09	18.13	12.74	8.38
March	......	20.20	18.00	12.65	8.36
April	......	20.18	18.00	12.62	8.34
May	......	20.18	17.99	12.61	8.32
June	......	20.19	17.98	12.59	8.30
July	$21.04	20.18	17.99	12.59	8 27
August	20.43	20.32	17.89	12.62	8.18
September	19.97	20.36	17.55	12.29	8.28
October	19.53	20.26	16.77	11.54	8.54
November	18.82	20.12	15.57	10.84	8.83
December	19.15	19.60	14.75	9.80	9.48

Source: *Standard Statistical Bulletin.*

Exhibit 5
Output of Small Cigarettes,* as Indicated by Tax Paid Withdrawals
(In billions)

1928	106
1929	119
1930	120
1931	113
1932	104

* Small cigarettes make up the greater part of the total product, large cigarettes amounting to only three or four billion per year.
Source: *Standard Statistical Bulletin.*

Exhibit 6
Cigarette Costs, per 1,000

Item	10-cent brand	15-cent brand
Government tax stamps..................	$3.00	$3.00
Tobacco (at $0.25 per lb. on the factory floor for the 10-cent brand, $0.39 for 15-cent brand).	0.57	0.90
Factory costs (labor and materials).....	0.185	0.21
Delivery.....	0.05	0.05
Selling and advertising...........	0.09	0.55
Depreciation and administration........ . ..	0.063	0 10
	$3.958	$4 81
Price to dealer..................	4.1895	6.036
Manufacturers' profit.........	$0.2315	$1.226
Retail price.............	5.00	7.50
Tax per manufacturers' price...	71.5%	50%

Exhibit 7
Piedmont Cigarette Company
Quotations of Company's Class A Common Stock on New York Curb Exchange*

Month	1928		1929		1930		1931		1932	
January.......	....	....	35½	43	36	41	36¼	37¾		(32)
February......	....	....	35	43½	39	43	38¼	41		
March........	49½	50½	36	37¼	42¾	49¾	39⅞	41¼		
April...	49½	51¾	32	35⅞	48	48	38	41½		
May..........	49¼	49⅝	33	35	44½	45¼	34⅛	37¾		
June..........	49	50⅝	33	36	41⅛	44⅞	36⅞	37½		
July..........	22	40¼	34⅝	36	41½	43	37½	38	30	30
August........	29	30	33¼	35⅜	42	46	(37)	(41½)	35	35
September.....	21¼	29	33	35	43⅛	43⅛	34⅛	39	48	52
October.......	29¾	37¼	33	43	40	45	34⅛	34½	47⅞	62
November.....	31⅛	37¾	30	38½	36¼	42	35⅛	35⅛	59½	70¼
December.....	35⅛	40	33	41	35¼	38	34⅛	36	60	75¼

* Figures show low and high sales for each month, except those in parentheses, which indicate bid and asked prices. No sales were recorded in the first half of 1932.

5. LANDON AUTO EQUIPMENT COMPANY

FINANCING INCREASE IN SALES

In May, 1934, Mr. F. C. Ames, a junior officer in a New York bank, was approached by Mr. J. H. Landon with the proposition that he invest $50,000, the major part of his paternal inheritance, in the Landon Auto Equipment Company. Mr. Ames was sufficiently well acquainted with Mr. Landon, who had been one of his father's friends, to know that he had spent practically his entire business life in building up the Holdwell Equipment Company, one of the most successful organizations in the automotive equipment industry. In 1928 he had resigned as executive vice president of this company because of a disagreement regarding management policies. The subsequent loss of the greater part of his small fortune in the stock market forced him to give up his original intention of retiring and to reenter active business.

In discussing the new proposition with Mr. Ames, Mr. Landon stated that, after considerable time and money spent in searching for a promising product in the field with which he was acquainted, he had discovered and purchased the patent rights for a windshield wiper which appeared to offer possibilities for profitable production. Used as original equipment on all automobiles and trucks, windshield wipers usually required replacement, at least in part, within two or three years. This particular device was superior in design and sturdiness to the only important competing windshield wiper, which had been manufactured profitably even during the depression. Aside from superior performance the chief advantage of Mr. Landon's product was the simplicity of its construction which permitted a dealer to stock a relatively small number of parts to meet his requirements. Even with these advantages Mr. Landon planned to sell the article at a price lower than that at which any competing products were offered.

After having the patents searched by a competent organization, Mr. Landon organized in December, 1933, the Landon Auto Equipment Company, of which he retained the entire capital stock; his remaining funds he invested in the purchase of equipment and inventory. For a monthly rental of $150 he secured, near New York City, a factory which he believed would permit him to handle any volume of business he would be likely to secure

in the next few years. Upon arrangement with various producers to supply the necessary parts, he began operations which consisted chiefly of assembly by unskilled workers. In view of the fact that Mr. Landon was the only official of the company and was drawing but a small salary, overhead expenses could be kept at a minimum, and therefore costs would tend to vary with volume of production.

In addition to organizing production, Mr. Landon engaged in active selling efforts, securing a contract to supply the Hi-Speed Truck Company as well as inducing the leading mail-order houses to stock this equipment to the exclusion of competing devices. With these and similar orders the company was attaining by April, 1934, a monthly sales volume of around $8,000, at which it could operate without loss.

Since he had been virtually promised a $50,000-a-month contract with a leading automobile manufacturer, if he could give assurance of financial strength and ability to produce on schedule, Mr. Landon was seeking additional capital, especially for the purchase of inventory. Mr. Landon was of the opinion that with such a volume annual profits of $100,000 could be realized at once. He believed, moreover, that at the end of four years the company, with only 30% of the market and no further cash investment, should be making annual profits of nearly $500,000.

The balance sheet in Exhibit 1 shows approximately the financial condition of the company at the end of April, 1934.

EXHIBIT 1
LANDON AUTO EQUIPMENT COMPANY
APPROXIMATE BALANCE SHEET, AS OF APRIL 30, 1934

ASSETS	
Cash	$ 3,500
Accounts Receivable	4,800
Inventories	6,000
Patents—Expense	25,000
Tools and Dies	5,700
Total Assets	$45,000
LIABILITIES	
Accounts Payable	$ 8,500
Common Stock	40,000
Less: Deficit	3,500
Total Liabilities	$45,000

Soon after the organization of the company an investment banking firm had offered \$150,000 for 60% of the capital stock, but Mr. Landon had refused this offer as he insisted upon retaining control of the company. If Mr. Ames should agree to invest \$50,000 in the Landon Auto Equipment Company, Mr. Landon proposed to donate 40% of his stock holdings to the company's treasury, and the donated treasury stock would then be conveyed to Mr. Ames.

Appraise Mr. Landon's plan for raising \$50,000 of new capital with particular reference to (*a*) the working capital requirements of the company in May, 1934; (*b*) the price asked for the stock offered for sale; (*c*) the possible alternative methods for financing an increase in sales of \$50,000 a month.

6. CENTURY WOODWORKING COMPANY

SECURING WORKING CAPITAL

In March, 1934, officers of the Century Woodworking Company were considering possible means of securing funds to strengthen the company's working capital position. Operating losses over a three-year period had impaired the company's financial condition to such an extent that the treasurer believed it would be difficult to finance any material increase in sales in the event of improving business.

The company, which manufactured windows, doors, sashes, and complete interior wood finishes for buildings of all kinds, was established about 1900 by two men, one a carpenter and contractor, the other experienced in the operation of woodworking machinery. Later a third man joined the firm, and over a period of years these three men, who owned the entire capital stock, built up an excellent business reputation for high-quality work. Their skill in making estimates, moreover, resulted in contracts which, for the most part, were profitable.

Originally, the mill's output was sold to contractors and subcontractors engaged in building two- and three-family houses, but since 1920 the majority of its products had been used in buildings of a more expensive type, such as better class residences, hospitals, and office buildings. Manufacturing operations were carried on in a building planned for efficient production and favorably located on the outskirts of a large city where taxes were moderate. In addition to the plant, the company owned dwelling houses and lots which were valued on its books at $13,000, but which were salable only at considerable sacrifice.

In view of the fact that the owners had always reinvested profits in the business, the company's standing with banks and lumber companies was good. For the payment of large lumber bills the company customarily used secured notes even though it might have a bank balance adequate to permit paying cash at the time of purchase. By so doing, in the opinion of the treasurer, the company would become known in the lumber trade as being exceedingly prompt in meeting obligations when due.

Despite the slump in the building industry in the earlier stages of the depression, this company, because of its standing and contracts, did not experience a marked decline in sales until the

latter half of 1932. From then on, conditions grew progressively worse until in the spring of 1934 only 10 men were employed in the shop as compared with a force of about 50 when operations were at capacity.

With sales of $150,000 annually, the owners estimated that they could each draw yearly salaries of $7,500 and in addition earn a small return on their invested capital. It was their opinion that the company could be operated without a loss with sales of $100,000 a year if their own salaries were considerably reduced and if all possible economies were put into effect.

In the spring of 1934, although the company's prospects for new business were better than at any time in the past two years, the management estimated that sales for the entire year would not exceed $75,000. Notwithstanding this unfavorable sales estimate, because of their past success and their belief that conditions in the building industry would improve, the owners of the Century Woodworking Company considered that the longer term outlook was favorable.

In March, 1934, with business showing signs of improvement, the company approached its bank in the hope of obtaining a loan. Although the bank's officers were friendly and expressed their confidence in the company's management, they refused to make any loans except on specific contracts held by the company. Moreover, the size of the advances was to be dependent not only on the value of the contract but also on the financial standing of the other party to it. The bank declined to grant a loan secured by a mortgage on the company's plant.

With other means of securing working capital closed, one of the owners suggested that they sell a share in their business to a young man who would be interested in joining them permanently. Particular emphasis was placed on finding a man with some financial training who would be able to concentrate his attention on credits and collections with a view to reducing the percentage of bad accounts. The owners, though without financial training or experience, considered that losses from bad debts were an important cause of the company's financial difficulties.

The owners decided, therefore, that each would contribute 200 shares of his 800, and these 600 shares then would be sold to the new member of the firm at a reasonable price. He would receive, in addition, a salary, although he could scarcely expect a large one until he was able to assume an active part in running the business.

For the 600 shares to be offered for sale, the owners believed that $25,000 would be a fair price and, furthermore, that this sum would be sufficient to place the company in a sound financial position. Financial data for the company appear in Exhibits 1–3.

1. Was $25,000 a fair estimate of the working capital requirements of the Century Woodworking Company in March, 1934?
2. Was $25,000 a reasonable appraisal of the value of the 600 shares of stock?
3. Present in detail, including a pro forma balance sheet, a financial plan which will place the company in a sound financial condition and at the same time will be equitable both to the old stockholders and to any contributor of new funds.

EXHIBIT 1
CENTURY WOODWORKING COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1930	1931	1932	1933
ASSETS				
Cash	$ 13,985	$ 6,193	$ 1,112	$ 356
Accounts Receivable	48,837	58,082	51,817	14,280
Mortgage Note Receivable	15,000	15,000		
Merchandise Inventory	15,128	6,441	4,240	3,120
Total Current Assets	$ 92,950	$ 85,716	$ 57,169	$ 17,756
Land	6,000	6,000	6,000	6,000
Buildings	42,580	42,580	42,580	42,580
Machinery and Equipment	21,958	21,958	21,958	21,958
Furniture and Fixtures	290	290	290	290
Building Improvements	8,758	8,758	8,758	8,758
Real Estate—Houses	12,971	12,971	12,971	12,971
Deferred Charges	2,650	2,405		
Total Assets	$188,157	$180,678	$149,726	$110,313
LIABILITIES				
Accounts Payable—Trade	$ 7,905	$ 2,120	$ 3,175	$ 1,530
Accounts Payable—Officers	27,424	32,636	2,636	2,636
Notes Payable	18,393	4,415	11,255	5,940
Mortgage Note Payable	9,000	9,000	9,000	9,000
Block Indebtedness	... .	5,200		
Total Current Liabilities	$ 62,722	$ 53,371	$ 26,066	$ 19,106
Reserves	26,352	32,660	38,778	44,897
Capital Stock	24,000	24,000	24,000	24,000
Surplus	75,083	70,647	60,882	22,310
Total Liabilities	$188,157	$180,678	$149,726	$110,313

EXHIBIT 2

CENTURY WOODWORKING COMPANY

STATEMENT OF COST OF GOODS SOLD, YEARS ENDED DECEMBER 31

Item	1925	1926	1927	1930	1931	1932	1933
Inventory, January 1.	$ 17,559	$ 15,112	$ 20,650	$ 13,670	$ 15,128	$ 6,441	$ 4 240
Purchases...	115,732	*	101,152	70,774	38,023	7,340	4,091
Less: Inventory, December 31	15,112	20,650	15,670	15,128	6,441	4,240	3,120
Cost of Material Used	$118,179	*	$106,132	$ 69,316	$ 46,710	$ 9,541	$ 5,211
Factory labor	50,144	*	65,255	52,834	36,561	17,275	11,346
Superintendence	6,432	*	5,705	6,639	5,688	3,782	
Power, heat, and water	4,390	*	4,926	5,784	4,763	2,121	822
Supplies	3,417	*	2,636	2,892	1,268	1,174	257
Property taxes	1,201	$ 1,100	1,012	1,601	1,998	1,770	1,333
Insurance	2,723	*	3,481	2,911	2,728	2,516	616
Repairs	11	*	.....	.....	.....	243	71
Auto expense	1,762	*	2,240	2,185	1,361	953	342
Depreciation	2,485	4,343	4,343	6,118	6,118	6,118	6,118
Miscellaneous expense	270	240	510	1,631	2,250	2,733	257
Cost of Goods Sold	$191,014	$178,711	$196,240	$151,911	$109,445	$48.226	$26,373

* Figures not available.

EXHIBIT 3
CENTURY WOODWORKING COMPANY
INCOME STATEMENT, YEARS ENDED DECEMBER 31

Item	1925	1926	1927	1930	1931	1932	1933
Sales	$255,269	$209,009	$244,281	$179,259	$135,918	$21,131	$25,359
Cost of goods sold	191,014	178,711	196,240	151,911	109,445	48,226	26,373
Gross profit	$ 64,255	$ 30,298	$ 48,041	$ 27,348	$ 26,473	$27,095[d]	$ 1,014[d]
Deduct:							
Officers' salaries	22,500	22,500	22,500	22,500	22,500	6,065	6,065
Office salaries and supplies	3,672	4,236	4,337	4,051	4,096	752	151
Telephone and telegraph	284	406	359	547	395	351	316
Corporate taxes	673	2,052	328				
Miscellaneous administrative expenses	204	1,523	3,134	....	....	....	425
Total administrative expenses	$ 27,333	$ 30,717	$ 30,658	$ 27,098	$ 26,991	$ 7,168	$ 6,957
Net operating income	$ 36,922	$ 419[d]	$ 17,383	$ 250	$ 518[d]	$34,263[d]	$ 7,971[d]
Add:							
Real estate income	510	....	469	1,100	652	652	663
Interest received	277	110	463	140	146	43	
Adjustment of notes receivable	10,143	....	4,122				
Total other income	$ 10,930	$ 110	$ 5,054	$ 1,240	$ 798	$ 695	$ 663
Total income	$ 47,852	$ 309[d]	$ 22,437	$ 1,490	$ 280	$33,568[d]	$ 7,308[d]
Deduct:							
Real estate expense	165	317	1,322	5,058	804	406	
Interest paid	477	958	1,312	900	650	540	270
Loss on bad debts	11,491	5,500	23,931	10,517	3,072	5,721	2,651*
Adjustment of notes payable	8,607						
Federal income taxes	3,396						
Total other charges	$ 24,136	$ 6,775	$ 26,565	$ 16,475	$ 4,526	$ 6,667	$ 2,921
Net income	$ 23,716	$ 7,084[d]	$ 4,128[d]	$ 14,985[d]	$ 4,246[d]	$40,235[d]†	$10,229[d]

* $27,343 of Accounts Receivable was charged off.
† $30,000 of Accounts Payable—Officers was taken off the books.
[d] Deficit.

7. TOWNE TIMEPIECE CORPORATION

APPLICATION FOR RECONSTRUCTION FINANCE CORPORATION LOAN

In June, 1934, the directors of the Towne Timepiece Corporation decided to secure, if possible, a three-year loan of $162,000 from the Reconstruction Finance Corporation[1] to finance the increase in inventory and pay rolls which expanding sales necessitated. In reply to an inquiry sent to the regional R. F. C. loan office, the company received a circular which contained the following information:

1. The R. F. C. would make loans up to $500,000 in amount to industrial concerns at the prevailing bank rate of interest. The maturity of the loan must not exceed five years.
2. Loans would be made primarily for working capital purposes, *i.e.*, for the payment of labor and for purchases of materials. Under certain circumstances an incidental portion of a loan might be used for:
   a. Payment on account of existing debt, provided such indebtedness was deferred and subordinated during the period of the loan.
   b. Payment of taxes.
   c. Repairs.
3. Loans would not be made to finance:
   a. Consumer purchases.
   b. Imports or exports.
   c. Promotion or expansion into new fields.
   d. New construction, primarily.
   e. Operation of a business in receivership, although application would be considered for loans contingent upon the termination of the receivership by a settlement with creditors or otherwise so that the business would be restored to a solvent condition.
   f. Companies which could borrow their entire requirements from banks.
   g. Insolvent companies. Applications would be received, nevertheless, from insolvent companies provided the applicant

[1] The Reconstruction Finance Corporation was created by an Act, signed January 22, 1932, which authorized the corporation to make loans to banks and insurance companies, to railroads, to farmers, and to exporters, all under important restrictions. Subsequent amendments to Sec. 5 of the original Act removed many of these limitations and empowered the corporation to lend to states and municipalities, to several newly created government credit agencies, *e.g.*, the Home Owners' Loan Corporation, and to corporations for self-liquidating construction projects. On September 14, 1933, the Act was further amended to permit loans to industry through banks and local mortgage loan companies. Direct loans to industry were authorized by another amending act signed by the President on June 19, 1934.

indicated the manner by which it would become solvent before time of disbursement of proposed loan, *e.g.*, by additional capital paid in or by settlement with creditors.

Originally established in 1875, the Towne Timepiece Corporation manufactured a well-known line of mechanical and electric clocks. The company constituted the chief industry in the small community in which it was located, and employed about 500 persons under normal conditions. The management had installed modern machinery and equipment to a limited extent only, but the plant was fairly efficient and new installations could be made gradually.

Despite a smaller volume of sales in the period 1927–1932 than in the previous five years, inventory had been increased considerably with a consequent weakening of the company's financial condition. In 1932 a sharp decrease in sales made it impossible for the company to raise funds with which to meet its bank loans, and a receiver was appointed by the court to take charge of the company's affairs.[1]

Under the receiver's management inventory was written down, costs were reduced, and the 1932 deficit of $163,000 was replaced by a profit of $27,000 for 1933. With the continuation of satisfactory earnings in the first quarter of 1934 the directors of the company looked forward to terminating the receivership, but they recognized that successful operation of the business would be contingent upon securing additional working capital.

After conferring with the R. F. C. regional loan administrator, the president of the Towne Timepiece Corporation made formal application for a loan of $162,000. The information and financial exhibits which accompanied the application follow.

Proposed Reorganization.—A new company would be organized to take over assets of the old. Under the reorganization, stockholders would have par value of their shares reduced from $100 to $20 per share, and creditors would settle for 80% of their claims. The new company would have no liabilities other than its debt to the R. F. C.

Purpose of Loan.—Funds obtained would be used to purchase inventory and to increase pay rolls; 50 additional employees would be hired if the loan were obtained.

Plan for Repayment of Loan.—Six months from date of loan an installment of $15,000 would be paid; at six-month intervals thereafter payments of $15,000 would be made until $75,000 of the principal had

[1] Discussion of reorganization and receivership aspects of this case should be postponed until cases in Sec. VIII are assigned.

EXHIBIT 1
TOWNE TIMEPIECE CORPORATION
BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933
ASSETS										
Cash	$ 41	$ 29	$ 77	$ 20	$ 29	$ 19	$ 13	$ 27	$ 53	$ 27
Receivables	242	200	184	169	173	155	167	128	75	118
Inventory	335	442	429	635	621	656	593	505	95	123
Total Current Assets	$618	$ 671	$ 690	$ 824	$ 823	$ 830	$ 773	$ 660	$223	$268
Real Estate, Plant, and Equipment (Net)	[illegible]	342	331	338	336	345	342	396	356	339
Other Assets	[illegible]	13	12	12	16	20	22	18	6	5
Total Assets	$984	[illegible]	$1,033	$1,174	$1,175	$1,195	$1,137	$1,074	$585	$612
LIABILITIES										
Notes Payable—Banks	....	$ 25	[illegible]	$ 85	$ 110	$ 75	$ 25	$ 70	$ 94	$ 94
Accounts Payable	$ 23	22	$ [illegible]	37	31	99	130	106	115	113
Total Current Liabilities	$ 23	$ 47	$ 23	$ [illegible]	$ 141	$ 174	$ 155	$ 176	$209	$207
Other Liabilities	14	18	8	9	6	8	5	153	6	11
Capital Stock	289	289	300	600	[illegible]	600	600	600	600	600
Surplus	620	634	683	416	[illegible]	413	377	145	230[d]	206[d]
Reserves	38	38	19	27	10					
Total Liabilities	$984	$1,026	$1,033	$1,174	$1,175	$1,195	$1,137	$1,074	$585	$612

[d] Deficit.

EXHIBIT 2
TOWNE TIMEPIECE CORPORATION
PRO FORMA BALANCE SHEET, AS OF APRIL 22, 1934
(In thousands of dollars)

Item	Giving Effect to Plan of Reorganization	Giving Effect to Reorganization and R. F. C. Loan
ASSETS		
Cash	....	$162
Accounts Receivable	....	
Merchandise	$ 80	80
Total Current Assets	$ 80	$242
Real Estate and Plant	193	193
Equipment	142	142
Total Assets	$415	$577
LIABILITIES		
First Mortgage—R. F. C.	....	$162
Capital Stock—Par $20	$120	120
Surplus	295	295
Total Liabilities	$415	$577

NOTES: *a. Inventory* $80,000.—Usable raw and in-process merchandise at cost, to be increased by use of proceeds of R. F. C. loan as required.

b. Real Estate, Plant, and Equipment $335,000.—Annual depreciation has been taken since 1920 at the rates of 2½ % on buildings, 10 % to 15 % on tools and machinery. Total reserve for depreciation is $486,000.

c. There are no delinquent real estate or other taxes.

EXHIBIT 3
TOWNE TIMEPIECE CORPORATION
INCOME STATEMENT, YEARS ENDED DECEMBER 31
(In thousands of dollars)

Item	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933
Sales	$1,594	$1,413	$1,319	$1,307	$1,229	$1,109	$1,136	$1,155	$642	$788
Cost of goods sold	1,253	1,086	1,053	1,002	971	910	986	956	641	633
Gross profit	$ 341	$ 327	$ 266	$ 305	$ 258	$ 199	$ 150	$ 199	$ 1	$155
Deduct: expenses	253	251	199	228	234	184	164	173	143	108
depreciation	36	36	38	26	26	28	30	29	24	25
Add: other income	12	10	10	11	8	8	8	6	3	5
Net profit	$ 64	$ 50	$ 39	$ 62	$ 6	$ 5[d]	$ 36[d]	$ 3	$163[d]	$ 27

[d] Deficit.

Exhibit 4
Towne Timepiece Corporation
Reconciliation of Surplus, January 1, 1924 to December 31, 1933

Surplus, January 1, 1924	$591,000
Add: net profit, 1924–1933	47,000
Deduct: Dividends paid or accrued	101,000
Capital stock dividend	300,000
Bad debts	40,000
Inventory adjustments 1931–1932	395,000
Miscellaneous adjustments	8,000
Total deductions	$844,000
Deficit, December 31, 1933	$206,000

Exhibit 5
Towne Timepiece Corporation
Stock Ownership and Compensation of Principal Officers and Directors

Name	Shares of common stock held	Years of service	Annual compensation
C. E. Johnson, president	1,100	8	None
O. R. Calvin, vice president	1,045	11	$4,500
A. M. Towne, treasurer	780	37	4,500
L. F. Hanson, sales manager	500	1	6,000
W. C. Brown, attorney	500	2	
T. R. Towne	20		
C. R. Towne	100		
	4,045		
Total stock outstanding	6,000		

III

RELATIONS WITH BANKS

1. ALBANY ICE AND FUEL COMPANY

APPLICATION FOR BANK LOAN TO INCREASE WORKING CAPITAL

Early in April, 1933, the Albany Ice and Fuel Company, wishing to increase its working capital, applied to the Hudson National Bank, a local depositary bank with which it had a line of credit of $80,000, for an unsecured four months' loan of $50,000.

The company was incorporated in New York in 1920, to acquire and operate eight companies engaged in harvesting and manufacturing ice and distributing it in Albany and the adjoining metropolitan area. During the next eight years it acquired seven similar companies, and by 1933 it was serving, in addition to the city of Albany, 10 other cities and towns in the surrounding territory. Approximately 60% of the ice it sold it harvested from its own lakes and ponds in the region northwest of Albany; the remaining 40% it manufactured in three plants located in or near the same city. All its plants, ice houses, machinery, and equipment were up to date and in excellent condition. It sold ice, both for cash and on credit, to householders, retail stores handling meat and groceries, and wholesale dealers who in turn sold to "ice peddlers." It also sold some ice direct to these peddlers, but for cash only.

In 1930 the company began to deal also in fuel oil, which it sold to industrial users, householders, and apartment houses. Most of its sales of oil were for cash, though sales were made to industrial users and large apartment houses on credit. For the distribution of oil to its customers during the winter season, it used ice trucks which could be equipped with tank bodies.

In April, 1933, at the time when it applied for the loan of $50,000, the company was planning to undertake the distribution of beer to retail dealers in the near future.

The application for the loan was referred to Mr. Thomas Wilson, a vice president of the Hudson National Bank. Mr. Wilson ascertained that the company wished to use the proceeds of the loan for meeting tax payments and current operating expenses. In examining the bank's credit files, he noted also the following facts relating to the company: The bank had secured its account in 1925 and had granted at that time a line of unsecured credit amounting to $80,000. During the six months' period from February to August, when its seasonal requirements in the way of working capital were greatest, the company had occasionally borrowed as much as $50,000 to $80,000 from the bank, but it had secured the greater part of its accommodation from the Albany Trust Company, with which it had established a line of credit of $300,000. It had borrowed, however, $80,000 from the Hudson National Bank in 1930, and $50,000 in 1931, the last year in which it had been in debt to the bank. It had always met its notes promptly at maturity and maintained satisfactory average balances, and its account had not been unduly active. It had built two of its three ice-manufacturing plants from reinvested earnings. The management of the company was well regarded by trade creditors, and bank checkings were equally favorable.

Since the loan of $50,000 would mature early in August, at a time when the company would be in a strong cash position, Mr. Wilson was certain that, if granted, it would be paid promptly at maturity. Shortly after the company applied for the loan, however, he ascertained independently that it no longer had any confirmed line of credit with the Albany Trust Company, and he suspected that the company had requested the loan of $50,000 from the Hudson National Bank as a result of its failure to obtain accommodation of this amount from the former institution.

Operating statements and balance sheets of the company for the years 1928–1932 are shown in Exhibits 1 and 2.

1. What should be done by the officers of the Albany Ice and Fuel Company to improve the relations between their company and its banks?

2. Under what conditions, if any, should the Hudson National Bank have granted the loan requested?

EXHIBIT 1
ALBANY ICE AND FUEL COMPANY
CONSOLIDATED INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1928	1929	1930	1931	1932
Ice sales	....	....	....	$3,619,000	$3,060,628
Fuel and miscellaneous sales	....	....	....	660,494	1,166,566
Miscellaneous nonoperating income	....	....	....	17,784	16,086
Total income	$4,303,166	$4,278,368	$4,233,870	$4,297,278	$4,243,280
Cost of goods sold	376,672	3,330,290†	1,037,456	1,339,058	1,603,066
Gross profit	$3,926,494	....	$3,196,414	$2,958,220	$2,640,214
Operating expenses, including maintenance }	3,018,008	....	2,232,896	1,722,686	1,675,082
Administrative expenses, taxes, etc }				442,494	436,782
Net profit from operations	$ 908,486	$ 948,078	$ 963,518	$ 793,040	$ 528,350
Bond interest	126,350	123,270	119,980	116,760	113,470
Dividends to minority interests	960	960	960		
Miscellaneous interest and tax refunds	....	38,554	51,914	36,378	29,040
Depreciation	....	287,082	294,786	283,708	195,844
Bad debts charged off	....	....	....	9,724	9,762
Estimated Federal taxes	....	32,500	30,000	24,000	
Net income	$ 781,176*	$ 465,712	$ 465,878	$ 322,470	$ 180,234
Preferred dividends	147,484	154,054	151,192	150,742	145,704
Common dividends	86,666	120,000	120,000	120,000	100,000

* Before depreciation, obsolescence, and Federal taxes.
† Includes also operating expenses, taxes, etc.

EXHIBIT 2
ALBANY ICE AND FUEL COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1928	1929	1930	1931	1932
ASSETS					
Cash	$ 300,882	$ 252,410	$ 125,660	$ 245,650	$ 101,988
Accounts Receivable }	126,962	148,196	{ 157,172	235,390	278,594
Notes Receivable }			{ 16,520	24,412	41,736
Cash Fund for Interest and Dividends	68,508	66,854			
Inventories	75,124	69,692	75,336	81,712	97,774
Accrued Interest Receivable	....	....	....	4,632	4,892
Investments	294,710	24,450	343,100	130,250	79,820
Total Current Assets	$ 866,186	$ 561,602	$ 717,788	$ 722,046	$ 604,804
Land and Buildings	4,221,056 }	6,147,328	{ 4,200,322	4,394,710	3,533,444
Machinery and Equipment	1,193,018 }		{ 1,799,680	1,789,566	1,523,490
	$5,414,074	$6,147,328	$6,000,002	$6,184,276	$5,056,934
Less: Depreciation	754,448	1,009,032	1,105,878	1,385,022	933,782
	$4,659,626	$5,138,296	$4,894,124	$4,799,254	$4,123,152
Cash with Trustee for Bond Interest	....	....	59,570	57,960	56,350
Hudson National Bank Release Account	....	....	....	30	30
Prepaid Insurance, Taxes, etc	84,042	81,224	66,864	77,158	71,780
Treasury Bonds	....	....	44,690	25,760	20,000
Treasury Stock	....	....	18,252	10,000	7,520
Fire Insurance Reserve Fund	50,014	77,986	81,336	93,772	73,818
Deferred Property Adjustment Account	....	....	....	....	732,650
Deferred Charges	....	8,540			
Suspense Account	....	....	....	14,612	15,492
Organization Expense	33,792	34,850	34,850	34,850	34,850
Flowage Rights and Established Routes	523,702	698,286	539,702	698,286	698,286
Total Assets	$6,217,362	$6,600,784	$6,457,176	$6,533,728	$6,438,732

EXHIBIT 2 (*Continued*)
ALBANY ICE AND FUEL COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1928	1929	1930	1931	1932
LIABILITIES					
Accounts Payable	$ 60,940	$ 52,304	$ 113,202	$ 275,234	$ 348,796
Notes Payable	....	82,350			
Accrued Expense	2,300	6,278	2,098	2,020	22,400
Accrued Interest, First Mortgage Bonds	62,790	61,250	59,570	57,960	56,350
Purchase Money Notes	30,102				
Dividends Payable	55,736	54,956	54,374	37,360	33,390
Reserve for Federal Taxes	34,000	45,434	30,000	24,000	11,248
Coupon Liability	....	....	....	2,760	2,608
Total Current Liabilities	$ 245,868	$ 302,572	$ 259,244	$ 399,334	$ 474,792
7% First Mortgage Bonds, Due 1950	1,784,776	1,746,000	1,702,000	1,656,000	1,610,000
Mortgages Payable	....	285,666			
Purchase Money Mortgages	60,000	70,000	173,974	115,650	88,430
Purchase Money Notes	....	....	183,200	107,600	81,300
Reserve for Fire Insurance	50,216	80,188	83,886	103,256	95,786
Preferred Stock	1,885,496	1,874,000	1,839,400	1,838,400	1,820,800
Common Stock	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Surplus	191,006	242,358	215,472	313,488	267,624
Total Liabilities	$6,217,362	$6,600,784	$6,457,176	$6,533,728	$6,438,732

2. INDIANA MACHINERY AND SUPPLY COMPANY

BORROWING UNDER LINE OF CREDIT CONDITIONED UPON PLEDGED RECEIVABLES AND INDORSEMENTS OF OFFICERS

About the middle of December, 1932, the Indiana Machinery and Supply Company, wishing to increase its working capital, requested the Wabash National Bank, one of its local depositary banks, to grant it a loan of $6,600 for 90 days.

The company had operated at a profit in every year since its incorporation in 1918. It sold building-construction and road-building machinery, equipment, and supplies to contractors in Indiana and adjoining states, and street-cleaning machinery and equipment to towns and cities in the same territory. Though it preferred to sell for cash whenever possible, a substantial proportion of its sales, both to contractors and to towns and cities, were made on open account. It also made some sales on the installment plan. In connection with its installment sales, it generally required the purchaser to make a substantial down payment and to give notes maturing within six months for the balance. Since it manufactured none of the products it sold, it required no factory or foundry buildings for its operations. The land and buildings it occupied, which were located in one of the largest cities in Indiana, had been leased for a long period on favorable terms.

In applying for the loan of $6,600, the president of the company went over its operating statements, shown in Exhibit 2, with Mr. George Anthony, the officer of the Wabash National Bank who handled the company's account. He pointed out to Mr. Anthony that net sales and gross profits had been maintained at satisfactory figures in 1930 and 1931, and that, though net profits had declined since 1929, earnings for 1931 would have been shown as $31,460, instead of $17,779, had not $13,681 of expenses attributable to earlier years been charged against income for that year. He stated also that office salaries had recently been reduced 10% and that, although net profits for the first 11 months of 1932 had fallen to less than $1,000, practically this entire amount represented earnings during October and November. Moreover, he called Mr. Anthony's attention to the fact that his company was then entirely free of bank debt,

and agreed to indorse the company's notes in case the bank granted the loan.

In looking over the bank's credit files, Mr. Anthony noted the following facts concerning the company's account: The bank had secured this account in 1926. At that time it had granted the company a line of credit amounting to $11,000 on its unsecured notes, with the personal indorsement of its president, and an additional line of the same amount on its indorsed notes receivable. In November, 1932, the company also had a line of credit of about $11,000 with each of two other local banks. The company had borrowed from the Wabash National Bank in every year from 1926 to 1932, but with one exception always had paid its notes at maturity and always had cleaned up its loans at least once a year. From 1926 to 1930 it had borrowed an average of about $9,000 from the bank; in 1931, about $6,600; in 1932, $4,400. The last amount mentioned had been borrowed for 90 days early in February. Though it represented in part a renewal of a loan obtained three months earlier, it had been repaid in full in April, 1932, a month in advance of maturity. The maximum amount the company had borrowed from the bank at any one time was approximately $32,000, which had been advanced in 1929 on both its own notes and its indorsed notes receivable. The company had maintained average balances commensurate with its borrowings from the bank until 1932. In that year it had allowed its balance to decline to an unsatisfactory figure. In November of the same year a leading mercantile credit agency had given the company a credit rating of the highest grade. Bank and trade checkings, though they had not been brought down to date, were also favorable. On the other hand, Mr. Anthony ascertained independently that the company at the end of November, 1932, had a contingent liability of approximately $38,000 in connection with accounts receivable discounted with a finance company. This liability was not shown on the company's balance sheet as of November 30, 1932; the balance sheet had not been audited.

1. By what actions had the Indiana Machinery and Supply Company impaired its relations with the Wabash National Bank?

2. What steps should be taken by the company to insure the cooperation of the bank at all times?

3. Should the bank have granted the loan of $6,600?

EXHIBIT 1
INDIANA MACHINERY AND SUPPLY COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1927	1928	1929	1930	1931	Nov. 30, 1932
ASSETS						
Cash	$ 29,157	$ 39,037	$ 28,785	$ 23,835	$ 21,309	$ 4,054
Accounts Receivable	163,049	116,045	167,385	130,149	194,926	124,709
Notes Receivable	24,201	25,704	18,100	29,300*	25,268†	24,754‡
Merchandise Inventory	41,162	69,799	55,417	62,320	45,089	36,775
Due from Finance Company	....	....	....	....	....	3,782
Total Current Assets	$257,569	$250,585	$269,687	$245,604	$286,592	$194,074
Investments:						
Cash Surrender Value—Life Insurance	5,902	7,640	9,423	975	1,368	1,368
Treasury Stock	....	....	....	....	1,018	1,017
Fixed Assets:						
Automobiles, Equipment, Furniture and Fixtures, Improvements to Leased Property, etc., Less Reserves	7,386	10,093	8,975	7,815	8,157	6,057
Contracts and Goodwill	55,000	55,000	55,000	55,000	55,000	55,000
Deferred Charges						
Prepaid Insurance, Interest, etc.	1,254	900	780	3,326	718	3,713
Total Assets	$327,111	$324,218	$343,865	$312,720	$352,853	$261,229
LIABILITIES						
Notes Payable—Banks	$ 41,800	$ 34,100	$ 35,200	$ 26,400	$ 46,200	
Notes Payable—Trade Creditors	....	....	2,640	....	....	$ 10,199
Trade Acceptances Payable	10,185	32,685	6,600			
Accounts Payable	83,523	52,099	72,975	69,253	72,829	23,155
Dividends Payable	....	....	7,066	3,533	2,085	
Total Current Liabilities	$135,508	$118,884	$124,481	$ 99,186	$121,114	$ 33,354
Reserve for Taxes	....	....	....	....	3,915	2,220
Common Stock, $100 Par Value	176,660	176,660	176,660	176,660	176,660	176,660
Surplus	14,943	28,674	42,724	36,874	51,164	48,995
Total Liabilities	$327,111	$324,218	$343,865	$312,720	$352,853	$261,229
Contingent Liabilities§	....	$ 1,829	....	$ 22,535	$ 12,594	

* Includes $27,472 of Notes Receivable—Employees, secured by company's common stock.
† Includes $17,344 of Notes Receivable—Employees, secured by company's common stock.
‡ Includes $15,376 of Notes Receivable—Employees, secured by company's common stock.
§ On account of customers' notes receivable discounted.

EXHIBIT 2
INDIANA MACHINERY AND SUPPLY COMPANY
OPERATING STATEMENT, YEARS ENDED DECEMBER 31

Item	1926	1927	1928	1929	1930	1931	1932*
Net sales	$774,397	$695,664	$742,413	$816,188	$800,068	$805,876	$426,823
Cost of sales	594,816	527,029	579,592	632,407	612,111	616,101	325,553
Gross profit	$179,581	$168,635	$162,821	$183,781	$187,957	$189,775	$101,270
Selling expenses	72,444	70,018	71,055	82,609	107,668	98,592	58,736
Administrative and general expenses	50,870	59,905	58,250	55,781	64,487	53,359	45,195
Operating profit	$ 56,267	$ 38,712	$ 33,516	$ 45,391	$ 15,802	$ 37,824	$ 2,661[d]
Other income	6,030	13,831	10,198	9,935	20,272	10,545	4,717
Total operating and other income	$ 62,297	$ 52,543	$ 43,714	$ 55,326	$ 36,074	$ 48,369	$ 2,056
Other charges	45,802	19,235	15,850	20,077	20,613	30,590	1,128
Net profit	$ 16,495	$ 33,308	$ 27,864	$ 35,249	$ 15,461	$ 17,779	$ 928
Dividends	.	21,371	14,133	21,199	13,539	3,533	

* First 11 months only.
[d] Deficit.

3. LORAIN BISCUIT COMPANY

POSSIBLE USE OF TRADE ACCEPTANCES FOR FINANCING SALES

Toward the close of August, 1932, at a time when it was heavily burdened with bank indebtedness and merchandise inventories, the Lorain Biscuit Company was confronted with the problem of raising about $150,000 of additional working capital required for financing operations for the remainder of the year, the period in which its manufacturing and sales activities would be at their seasonal peak.

The company was incorporated in Ohio in 1924 and had been actively managed since that time by its president, Mr. W. S. Reynolds. Its products, which were sold to the retail trade only, included a wide variety of high-grade biscuits. Its executive offices and plant were located in one of the largest cities in Ohio. The plant it occupied was of recent construction and up to date in every respect. Toward the close of 1931 it acquired all the assets and assumed all the liabilities of another biscuit company whose products were similar to its own. The increase in the company's assets and liabilities which resulted from this consolidation is reflected in its balance sheet as of December 31, 1931, shown in Exhibit 1.

As is indicated by the operating statements shown in Exhibit 2, the company's operations during the three years preceding 1931 were very successful. In 1931, however, net earnings fell to less than $10,000. At the close of the year, moreover, the company's books showed abnormally large amounts of accounts receivable, merchandise inventories, and notes payable to banks. During the next six months, which were generally the dullest months of the entire year, the company succeeded in maintaining a satisfactory volume of sales, in reducing its accounts receivable substantially, and in making a small profit. It failed, however, to reduce either its inventories or its bank debts to the extent considered desirable. During July and the first week of August, 1932, it was able to effect but a slight reduction in merchandise inventories and notes payable to banks.

By the beginning of the fourth week in August, the company found itself in an embarrassing position. Orders were coming in at that time in satisfactory volume, and Mr. Reynolds

believed that sales for the rest of the year would show the usual seasonal increase. In order to fill the large orders which were then coming in, however, he estimated that his company would require about $150,000 of additional working capital. He was of the opinion that this amount, together with income expected from current operations, would be sufficient to meet the company's financial requirements for the rest of the year, but he expected that some difficulty would be encountered in any attempt to raise so large an amount of short-term funds as his business then required.

At this time the company had a line of credit of $240,000 with each of its two main depositary banks, the Erie Trust Company and the Lakeport National Bank, and smaller lines with two other local banks, but it already owed the Erie Trust Company $120,000, the Lakeport National Bank $192,000, and other banks about $144,000. Moreover, it had been continuously and rather heavily in debt to its main depositaries for nearly a year. Consequently, while he would have preferred to obtain from the latter institutions the additional working capital required, Mr. Reynolds doubted that these two banks would be willing under the circumstances to grant his company any substantial further advances.

As possibly the next most available method of meeting the financial requirements of his company, Mr. Reynolds was considering the advisability of resorting to the use of trade acceptances. From time to time during the months immediately preceding he had noticed newspaper articles in which the advantages of the trade acceptance as an improved form of credit instrument, and as a means of stimulating business and making available increased amounts of credit to comparatively small borrowers, had been explained at some length. His attention had been attracted in particular to the following excerpts from articles in New York newspapers:

> The Banking and Industrial Committee, headed by Owen D. Young, which was formed last month to help make effective the credit expansion program of the Federal Reserve System, issued yesterday a statement endorsing the proposal for using trade acceptances as a substitute for open book accounts.
>
> The trade-acceptance plan has been under discussion for several months and was called to the attention of the Young Committee soon after that body was organized. The plan is sponsored by Irenee du Pont, vice chairman of E. I. du Pont de Nemours & Co., and by executive officers of the Westinghouse Electric and Manufacturing Company,

the General Motors Corporation, the Bethlehem Steel Corporation, the General Electric Company, and others, as well as by numerous bankers. It contemplates that, instead of financing sales through the use of open book credits, these companies and their customers will employ trade acceptances which can be discounted in the open market, thereby increasing the volume of commercial paper available for bank investments.

. . . . . .

The Statement of the Young Committee follows:

"The banking and industrial committee of the Second Federal Reserve District believes that the present time is opportune for renewal of a campaign for better business methods through the use of trade acceptances as a substitute for open book accounts. It is hoped that the grant of banking accommodation to manufacturers and merchants will be facilitated through the discount of approved trade bills in place of cash advances on one-name promissory notes of borrowers.

"This should result in the use of additional bank credit in increased movements of goods and raw materials, and lead to increased employment in industry. The committee therefore strongly advocates the proper extension of trade acceptance terms and has recommended to the American Acceptance Council, the National Credit Men's Association and the Federal Reserve Banks that they use their facilities to bring about an enlargement of the use of trade acceptances, and to that end that they appoint a committee to deal with the matter.

"Efforts to obtain a wider use of trade acceptances have been made in this country ever since the introduction of the bankers' acceptance following the formation of the Federal Reserve System. The late Paul M. Warburg was one of the staunchest advocates of trade acceptances and declared that their use made for sounder business and banking conditions. Where business is not done on a strictly cash basis, he said, the trade acceptance would be found to be the safer, sounder and, in the long run, more economical method than the open accounts.

"Trade acceptances are used at present to a limited extent and bill dealers trade in such paper at rates about three-eighths to five-eighths of one per cent above the discounts quoted on bankers' bills. Among small merchants, however, there has existed a prejudice against trade acceptances, and they are frequently referred to disparagingly as 'dunning credits.'"[1]

. . . . . .

Interest in trade acceptances has awakened on all sides since the banking and industrial committee under the chairmanship of Owen D. Young endorsed the plan a few weeks ago, according to Robert H. Bean, executive manager of the acceptance council. Inquiries have come into the offices of the council from all parts of the country, many of them from the major officials of the largest industrial companies.

"A cross-section of the industries represented in this flood of new inquiries," Mr. Bean said yesterday, "includes two of the largest and most prominent steel manufacturers, two railroad companies, a New England paper manufacturer, a prominent manufacturing chemist,

[1] *New York Times*, June 28, 1932.

a manufacturer of explosives, a sporting goods distributor, a mid-Western publisher, a manufacturer of iron castings, a nationally known shoe manufacturer, a New England malleable iron-works concern, a large motor construction company, an engineering concern, an investment bankers' organization, the world's largest telephone and telegraph company, a construction and roofing company, a manufacturer of hats and felts, a manufacturer of automobile axles, a mid-Western paint company, the largest producer of lead, a well-known agricultural implements concern, a manufacturer of pipe contractors' supplies, a large coal mine, a street railway company, a distributor of hosiery, a radiator manufacturer, a Southern pulp and paper company, a well-known textile concern, a manufacturer of grinding machines, a straw hat manufacturer, a manufacturer of celluloid, a well-known maker of car wheels, a Pennsylvania anthracite coal mining company, a woodworking machinery concern, a real estate distributor, a well-known leather manufacturer, engineer and municipal builders, steel construction companies, envelope and stationery manufacturers, printing type manufacturers, makers of pumps, phosphate, hardware, fuses, cement, motor trucks, tires, typewriters, etc."

Both from the commercial and the banking standpoints, Mr. Bean said, the trade acceptance permits a broader and wider extension of credit than any other credit instrument employed directly in domestic trade. Bankers and industrialists, he said, now recognize in the trade bill the ideal means for bridging the gap between the abundant credit supplies of the American banks and the vast fields of industrial and agricultural production from which the requirements of the markets are met.[1]

. . . . . .

The New York Federal Reserve Bank has established a buying rate of 2% for purchase of prime endorsed trade acceptances in the open market. The bank can buy trade bills of maturities up to 90 days, the rate therefore applying to all maturities purchasable. Previously, the bank purchased prime trade acceptances at the rediscount rate, now 2½%, so that the new rate represents a reduction of ½% in the buying rate. Chief cause of the action was that the rediscount rate is now far above the general level of credit rates.

Leaders in the campaign for increased use of trade acceptances, as well as dealers in bills, expressed pleasure over the Reserve Bank's action. The move in a sense marked the first official act of the central institution indicating approval of the extension of acceptance financing in industry. The bank thereby showed its readiness to cooperate in creating an active and reliable market for the paper.

In order to be eligible for purchase, the bills must carry a banking endorsement and a maturity date of 90 days or less. The 2% rate represents the minimum discount on paper bearing the highest grade names. Some bills will probably be bought by the bank in the next few days.

Furthermore, the bank established a rate well in line with rates at which trade acceptances have been moving in the open market, thus

[1] *New York Times*, July 13, 1932.

assuring dealers of an opportunity to dispose of their holdings, if the necessity should arise, without appreciable loss. Trade bills have been selling in the market at rates ranging from 1⅜% to 2¼%, depending upon the quality of the names.

Dealers report that the amount of bills appearing is slowly expanding both in volume and in number of corporations offering them. It is understood that banks also are receiving bills in larger volume, although not yet in such amounts as to affect their credit figures materially. The open market anticipates that when credit conditions have firmed slightly, both banks and corporations will offer acceptances in large enough numbers to create active trading.

The action of the Reserve Bank in reducing its rate therefore assures the bill dealers, as well as the corporations adopting the practice, of a completely free and flexible market.[1]

Up to this time the Lorain Biscuit Company had made no use of the trade acceptance. Instead, it customarily sold its products for cash and on open account, terms of sale being 2% 10 days, net 30 days; and it borrowed on its unsecured promissory note, either direct from its own local banks or in the open market, its seasonal requirements in the way of short-term capital. Not being thoroughly familiar with the practical operation of the trade-acceptance system, Mr. Reynolds felt some doubt as to whether it would be adaptable, without undue expense and delay, to his particular business. He therefore decided to call on Mr. Edward Maxwell, an officer of the Erie Trust Company, to find out, first, whether the bank would be willing to advance his business an additional $60,000; and, second, whether in the opinion of the bank's officers the use of trade acceptances would be of any material help in the solution of his financial problems.

In looking through the bank's credit files, Mr. Maxwell noted that both trade and bank checkings of the company for a number of years had been uniformly favorable, that the company practically always took advantage of cash discounts offered and paid its bills promptly, and that Mr. Reynolds was regarded both by banks and by trade creditors as a man of high moral character and of unusual ability in his line of business.

1. What action should the Lorain Biscuit Company have taken with respect to the adoption of the trade-acceptance method of financing its sales?

2. Should the Erie Trust Company have made an additional advance of $60,000 to the company?

[1] *Wall Street Journal*, August 6, 1932.

EXHIBIT I
LORAIN BISCUIT COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1928	1929	1930	1931	March 31, 1932	June 30, 1932
ASSETS						
Cash	$ 47,233	$ 91,720	$ 56,887	$ 57,350	$ 80,975	$ 50,263
Notes and Bills Receivable—Customers	1,152	240	7,546	23,194	28,735	21,298
Accounts Receivable—Customers	174,050	254,491	213,476	462,625	380,633	238,478
Merchandise	362,001	399,360	561,250	777,597	729,761	727,665
Miscellaneous Items—Current	....	....	4,591			
United States Government Securities	4,098	4,080	4,080	4,080	4,080	4,080
Total Current Assets	$ 588,534	$ 749,891	$ 847,830	$1,324,846	$1,224,184	$1,041,784
Machinery and Fixtures	310,780	293,788	294,957	385,733	344,366	354,343
Investments	....	....	5,520	277,592	268,686	297,606
Other Notes and Accounts Receivable	23,153	10,482	4,164	23,238	17,220	70,355
Miscellaneous Items—Slow	15,849	16,155	29,825	38,666	57,189	78,802
Goodwill	270,000	240,000	240,000			
Real Estate in Huron Heights	....	....	....	54,000	54,000	54,000
Cash Value of Life Insurance	....	....	....	28,799	28,799	32,901
Total Assets	$1,208,316	$1,310,316	$1,422,296	$2,132,874	$1,994,444	$1,929,791
LIABILITIES						
Notes Payable to Banks	$ 180,000	$ 186,000	$ 240,000	$ 699,600	$ 572,400	$ 457,200
Notes and Bills Payable for Merchandise	....	....	4,591	....	....	3,693
Accounts Payable for Merchandise	7,746	20,946	16,950	93,879	104,865	116,670
Miscellaneous Items—Current	13,200	27,000	18,317	15,956	18,299	20,435
Total Current Liabilities	$ 200,946	$ 233,946	$ 279,858	$ 809,435	$ 695,564	$ 597,998
Loans against Life Insurance	....	....	....	....	....	29,474
Reserves	137,029	120,856	146,560	175,864	143,801	150,411
8 % Cumulative Preferred Stock	300,000	300,000	300,000	83,520	77,520	77,520
7 % Cumulative Preferred Stock	....	....	....	276,480	282,480	282,480
Common Stock	300,000	300,000	300,000			
Surplus and Undivided Profits	270,341	355,514	395,878	787,575	795,079	791,908
Total Liabilities	$1,208,316	$1,310,316	$1,422,296	$2,132,874	$1,994,444	$1,929,791

EXHIBIT 2
LORAIN BISCUIT COMPANY
OPERATING STATEMENT, YEARS ENDED DECEMBER 31

Item	1928	1929	1930	1931	6 months ended June 30, 1932
Net sales	$2,354,833	$2,506,312	$1,929,532	$3,058,523	$1,002,074
Gross profit	....	....	.	483,573	166,241
General and selling expense	....	....	1,813,765†	410,541	135,226
Operating profit	....	....	115,767	73,032	31,015
Other income	....	....	4,411	412	337
Charges against income	....	....	32,399	64,182	13,227
Net income	102,101*	192,794*	87,779	9,262	18,125
Dividends—preferred stock	48,000	48,000	48,000	47,576	12,988
Dividends—common stock		...	...	36,600	
Adjustments		.	.	466,611	805
Increase in surplus	41,344	85,174	40,364	391,697	4,332

* After depreciation but before taxes.
† Included cost of sales also

4. DEARBORN MANUFACTURING COMPANY (I)

APPLICATION FOR PERSONAL SECURED LOAN

Early in January, 1933, the Northwestern National Bank of Chicago was considering the advisability of granting a loan of $40,000 to Mr. Thomas Benton, president of the Dearborn Manufacturing Company, on two notes of $20,000 each. These notes were to be signed jointly by Mr. Benton and one of his brothers, who was also an officer of the company. The proceeds of the loan, if granted, together with $10,000 which Mr. Benton and his brother already had available for the purpose, were to be used to purchase 644 shares of the company's outstanding common and 2,838 shares of its outstanding preferred stock. The sale of this stock to Mr. Benton had already been authorized by the directors of the Dearborn Manufacturing Company, and it had been agreed that the proceeds of the sale were to go to the company's treasury. The shareholders of the company, other than the Benton brothers, realizing that their business needed additional working capital, and being willing to make some sacrifice in order to raise this capital, had agreed to contribute to the company on a pro rata basis the 3,482 shares which Mr. Benton proposed to purchase.

The Dearborn Manufacturing Company made labels, tags, envelopes, blotters, calendars, and other paper products, which it sold mainly to retail dealers in stationery and office supplies; and popular games, which were sold to chain 5- and 10-cent stores and other retail dealers. It had been organized early in June, 1931, as a consolidation of four smaller companies which for a number of years previously had been engaged in the manufacture of similar products in the metropolitan area of Chicago. Since this consolidation had been effected about the beginning of the busiest season of the four smaller companies and had necessitated the transfer of activities from the scattered plants of the several smaller concerns to a single larger plant, the company had operated at a considerable disadvantage during the seven months ended December 31, 1931, and had not brought its operations to a state of efficiency until near the close of that period. Its factory buildings, though not of recent construction, had been well maintained, and its machinery and equipment were up to date and in good condition.

At the time when Mr. Benton applied for the joint loan of $40,000 he owed the Northwestern National Bank $10,000, the amount of a loan which he had obtained on his unsecured personal note some two years previously and renewed several times at maturity; and the Dearborn Manufacturing Company owed the bank $60,000 on its unsecured notes payable. If the proposed joint loan were granted, Mr. Benton agreed to reduce the company's notes payable of $60,000 and the joint loan of $40,000 as follows:

1. $40,000 of the company's loan of $60,000 as soon as the proceeds of the joint loan should be made available.
2. $10,000 of the company's loan in April, 1933.
3. The remaining $10,000 of the company's loan in June, 1933, or sooner.
4. $20,000 of the joint loan within one year (*i.e.*, on or before January 1, 1934).
5. The remaining $20,000 of the joint loan within 30 months (*i.e.*, on or before July 1, 1935).

Thus under this plan the combined indebtedness of Mr. Benton and the Dearborn Manufacturing Company to the Northwestern National Bank would be reduced within a year to $30,000, as compared with the $70,000 owed the bank in January, 1933.

In order to secure the proposed loan, Mr. Benton agreed to:

1. Sign over to the bank all rights to a trust fund of $40,000 which, on the death of his mother, who was then sixty years old, would revert to himself, his two brothers, and his sister, all of whom had agreed, for value received from him, to sign over their interest in this fund during the life of the loan.
2. To secure the indorsement of either one of two Chicago corporations on the second of the two $20,000 notes which were to be signed by himself and his brother if the proposed joint loan were granted. The first of these two corporations had a net worth in excess of $2,000,000; the second, a net worth estimated at $150,000 to $250,000. Both had the highest credit rating.
3. To indorse to the bank 1,100 shares of the Dearborn Manufacturing Company's preferred and 3,530 shares of its common stock, which would constitute a majority of the 8,912 shares of voting stock issued or to be issued. In this connection Mr. Benton stated that the company was then carrying insurance of $100,000 on his life, under an agreement, in the event of his death and on the request of his administrator, to buy in the company's stock held by him at the time of his demise at

its book value as of that time. Assuming that the book value of the preferred stock at such time, after the $50,000 had been turned over to the company's treasury and after deduction of about $20,310 included as goodwill and deferred charges among the assets shown on the company's latest balance sheet (December 31, 1932), would be about $90 a share, he explained that the book value of the common stock, after the company had collected the $100,000 from the insurance companies, would be about $50,880, or slightly more than $10 a share on 5,000 shares. (One hundred thousand dollars received by the company from the life insurance, less a total of $49,120—consisting of $39,120, the amount required to bring the value of the outstanding 3,912 shares of preferred stock up to par, and $10,000 of premium loans against the life insurance, the maximum amount of such loans which could be outstanding during the life of the proposed joint loan.) The total value of the 1,100 shares of preferred and the 3,530 shares of common stock to be pledged as collateral for the proposed joint loan would under such conditions be about $145,300 ($110,000 for the 1,100 shares of preferred at $100 a share and $35,300 for the 3,530 shares of common at $10 a share).

Mr. Benton explained further that, while the company admittedly was in need of additional working capital at that time, his main reason for requesting the loan of $40,000 was that the company needed a stronger and more responsible leadership, "backed by stock," even more than it needed additional capital; and that, provided he could secure the necessary stock control as proposed, he firmly believed he could supply the required leadership better than any of his associates in the business. He was of the opinion that, without such leadership, the progress of the company would be hampered in the future as seriously as it had been ever since the consolidation of the four smaller concerns in 1931.

As reasons which he thought would justify the bank in granting the proposed loan, Mr. Benton then pointed out that

1. The security offered appeared to be satisfactory.
2. In 1932, under the worst business conditions he had experienced in the paper-products industry in more than 20 years, the company had made real progress.
3. The condition of the company at the beginning of 1933, as compared with some of its large competitors, was very favorable; and it was better than that of any of its competitors which did about the same volume of business in the same district during the year 1932. [Balance sheets, analysis of the deficit account, and operating statements of the company for 1931 and 1932 are shown in Exhibits 1 to 3.]
4. Operations for 1933 were expected to result in a minimum cash gain of more than $70,000 and an actual cash gain of more than $112,000.

In support of the last statement, Mr. Benton submitted the schedules of estimated minimum and of actual sales, costs, and profits shown in Exhibits 4 and 5. The estimates of increased sales and profits during the second as compared with the first half of 1933 he justified on the ground that the company's business was distinctly seasonal, 60% of its total volume of sales generally being made during the last half of the year. He stated further that he believed the estimate of actual sales and profits for 1933 was conservative, particularly in view of the fact that two new products which the company had recently introduced were proving very profitable.

The Northwestern National Bank had secured the account of the Dearborn Manufacturing Company early in June, 1931, at the time of the consolidation. For about fifteen years before that time it had had the account of the largest of the four consolidating companies, the Sheridan Paper Products Company, which had been operated with fair success for a number of years by Mr. Benton and his brothers. The management of the Dearborn Manufacturing Company was favorably regarded in trade circles, as well as by the bank. Two of the bank's officers were of the opinion that the company had followed excessively liberal policies with respect to executives' salaries in the past, but Mr. Benton agreed that, whether the proposed loan were granted or not, the company would build up a substantial surplus before considering salary disbursements of any considerable amount. The bank had granted the company a credit line of $40,000 when it secured the account. In the following year the line of credit had been increased temporarily to $60,000. During the years 1931 and 1932 the company's indebtedness to the bank had averaged about $50,000. It had reduced its loans from the bank to $30,000 at one time in 1931 and to $40,000 in 1932, but early in January, 1933, as was stated above, it owed the bank $60,000, the full amount of its line of credit. All its loans had been "straight," *i.e.*, unsecured. Until the fall of 1932 its average balance with the bank had been satisfactory. The only other bank account it maintained was a small deposit account with another local institution.

At the time of Mr. Benton's application for the advance of $40,000, the bank had a substantial amount of surplus funds available for loans to its own customers. Prevailing rates were then 1½% on prime four to six months' commercial paper,

⅜% on prime 90-day bankers' bills, ½% on stock exchange 90-day time loans, and 1% on call loans, and the average yield on U. S. Treasury bonds was 3.39%. On three to six months' U. S. Treasury notes and certificates the yield had recently been as low as .07%. On the other hand, Mr. Benton had agreed that, if the bank decided to grant the loan of $40,000, both the joint notes of $20,000 should be discounted at the rate of 6% a year.

1. Should the Northwestern National Bank have taken favorable action on the proposed loan of $40,000?

2. In the event that it had granted the loan, what restrictions or conditions, if any, should it have imposed in order to protect its advance?

EXHIBIT 1
DEARBORN MANUFACTURING COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1931	1932
ASSETS		
Cash	$ 10,520	$ 14,382
Accounts Receivable	52,042	128,680
Notes Receivable*	6,518	2,800
Merchandise Inventory†	101,402	90,554
Cash Surrender Value of Life Insurance, Less Loans‡	2,838	2,080
Prepaid Expenses	9,328	8,100
Total Current Assets	$182,648	$246,596
Investments	426	800
Land and Buildings§	67,364	65,580
Machinery and Equipment§	236,162	204,036
Office Equipment§	3,852	3,270
Deferred Charges	17,464	18,308
Goodwill	2,000	2,000
Total Assets	$509,916	$540,590
LIABILITIES		
Accounts and Acceptances Payable	$ 32,922	$ 87,440
Notes Payable—Bank	40,000	60,000
Notes Payable—Others	40,136	30,602**
Accrued Expenses	8,056	10,086
Provision for Taxes	630	190
Total Current Liabilities	$121,744	$188,318
Mortgages Payable	32,000	29,800
Preferred Stock‖	391,200	391,200
Common Stock¶	2,118	2,118
Deficit	37,146	70,846
Total Liabilities	$509,916	$540,590

* Less notes discounted amounting to $11,936 as of December 31, 1931.

† Priced as follows: raw materials, at market; goods in process, at manufacturing cost; finished goods, at selling price less 5%.

‡ Loans of $10,044 as of December 31, 1931, and $13,666 as of December 31, 1932.

§ Fixed assets carried at appraisal values agreed on at time of consolidation, plus cost of subsequent additions, less depreciation at the following rates: buildings, 5% a year; machinery, factory fixtures, office furniture and fixtures, and alterations and improvements, 10%; motors, printing equipment, service-station equipment, and office machines, 20%; delivery equipment, 25%.

‖ 3,912 shares 7%, cumulative, $100 par. Accumulated dividends on this stock as of December 31, 1932, amounted to 9%.

¶ 4,314 shares, no par value.

** $12,350 of this amount represented loans to the company from its executives.

EXHIBIT 2
DEARBORN MANUFACTURING COMPANY
ANALYSIS OF DEFICIT ACCOUNT

DECEMBER 31, 1931	
Net Loss for 7 Months Ended December 31, 1931	$33,912
Reserve for Bad Accounts	9,924
	$43,836
Deduct:	
Increase in Cash Surrender Value of Life Insurance	6,690
Deficit, December 31, 1931	$37,146
DECEMBER 31, 1932	
Balance, January 1, 1932	$37,146
Add:	
Net Loss for Year Ended December 31, 1932	35,024
Reserve for Doubtful Accounts	1,538
	$73,708
Deduct:	
Increase in Cash Surrender Value of Life Insurance	2,862
Deficit, December 31, 1932	$70,846

EXHIBIT 3
DEARBORN MANUFACTURING COMPANY
INCOME ACCOUNT

Item	7 months ended Dec. 31, 1931	Year ended Dec. 31, 1932
Net sales	$518,038	$628,480
Cost of sales*	404,582	487,516
Gross profit	$113,456	$140,964
Operating expenses*		
Delivery	18,626	21,200
Selling	35,188	37,550
Administrative	59,042	56,536
Total operating expenses	$112,856	$115,286
Net income from operations	600	25,678
Other expenses less other income*	34,512	60,702
Net loss	$ 33,912	$ 35,024

* Depreciation charges are included in cost of sales, operating expenses, and other expenses less other income.

EXHIBIT 4
DEARBORN MANUFACTURING COMPANY
ESTIMATED MINIMUM SALES, COSTS, AND PROFITS, 1933

Item	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
Sales of paper products	$50,000	$50,000	$50,000	$50,000	$40,000	$40,000	$40,000	$50,000	$70,000	$ 90,000	$ 80,000	$50,000	$660,000
Sales of games	10,000	15,000	15,000	10,000	5,000	5,000	5,000	10,000	15,000	20,000	30,000	30,000	170,000
Total sales	$60,000	$65,000	$65,000	$60,000	$45,000	$45,000	$45,000	$60,000	$85,000	$110,000	$110,000	$80,000	$830,000
Costs:													
Merchandise	22,000	24,600	24,600	22,000	16,200	16,200	16,200	22,000	31,400	40,600	42,200	32,000	310,000
Direct labor	12,600	13,200	13,200	12,600	9,600	9,600	9,600	12,600	17,600	22,800	22,200	15,600	171,200
Indirect labor	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	5,000	5,500	5,500	5,000	57,000
Commissions and expenses	800	1,200	1,200	800	400	400	400	800	1,200	1,600	2,400	2,400	13,600
Manufacturing expenses	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	12,000	14,000	14,000	12,000	124,000
Office wages	2,400	2,400	2,400	2,400	2,200	2,200	2,200	2,400	2,600	3,000	3,000	2,400	29,600
Delivery wages	2,000	2,000	2,000	1,800	1,500	1,500	1,500	1,800	2,000	2,400	2,400	2,000	22,900
Sales and administrative salaries	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	72,000
Total costs	$59,300	$62,900	$62,900	$59,100	$49,400	$49,400	$49,400	$59,100	$77,800	$95,900	$97,700	$77,400	$800,300
Gain or loss	+700	+2,100	+2,100	+900	−4,400	−4,400	−4,400	+900	+7,200	+14,100	+12,300	+2,600	+29,700
Depreciation included in manufacturing expenses	3,400	3,400	3,400	3,400	3,400	3,400	3,400	3,400	3,400	3,400	3,400	3,400	40,800
Cash gain or loss each month	+$4,100	+$5,500	+$ 5,500	+$ 4,300	−$ 1,000	−$ 1,000	−$ 1,000	+$ 4,300	+$10,600	+$17,500	+$15,700	+$ 6,000	+$70,500
Cash gain or loss, cumulative	....	+ 9,600	+ 15,100	+ 19,400	+ 18,400	+ 17,400	+ 16,400	+ 20,700	+ 31,300	+ 48,800	+ 64,500	+ 70,500	+ 70,500

EXHIBIT 5

DEARBORN MANUFACTURING COMPANY

ESTIMATED ACTUAL SALES, COSTS, AND PROFITS, 1933

Item	January through June	July through December	Total, 1933	Estimated minimum	Excess above estimated minimum
Sales of paper products	$320,000	$420,000	$ 740,000	$660,000	$ 80,000
Sales of games	90,000	180,000	270,000	170,000	100,000
	$410,000	$600,000	$1,010,000	$830,000	$180,000
Increased costs:					
Merchandise			77,200		
Direct labor			32,600		
Indirect labor			5,000		
Manufacturing expenses			10,000		
Office and delivery expenses			5,000		
Salaries and commissions			8,000		
Total costs					137,800
Estimated additional gain					42,200
Estimated minimum gain (as above)					29,700
Total estimated actual profits					$ 71,900
Depreciation charges					40,800
Total estimated actual cash gain					$112,700

5. DEARBORN MANUFACTURING COMPANY (II)

ACTION TO BE TAKEN BY BANK UPON MATURING LOANS

In August, 1933, the Northwestern National Bank of Chicago was faced with the problem of deciding what policy it should adopt with respect to the collection of its three loans to the Dearborn Manufacturing Company, one of $10,000, and two of $20,000. The note for $10,000 had last been renewed on July 14, for one month; the other two notes, on July 20 and July 26, respectively, for one month also.

For the six months ending March 31, 1933, the Dearborn Manufacturing Company showed a net profit from operations of $84,000, of which about $60,000 represented earnings for the first quarter of 1933. In May, 1933, moreover, the management agreed not to make salary disbursements of any considerable amounts, in order to build up a substantial surplus. As late as June, 1933, the management had been well regarded both in trade circles and by the bank.

Despite these favorable circumstances, after March, 1933, partly because of conditions which began to develop during the banking moratorium, and partly because of a sudden decrease in the demand for puzzles, sales of the company declined considerably more than was to have been expected on account of the seasonal character of its business. In view of these facts, the officers of the Northwestern National Bank felt serious doubts as to the ability of the company to meet the three notes which would mature within a few weeks and therefore found it necessary early in August to formulate some plan for dealing with the situation in which the company had become involved by that time.

At the beginning of 1933 the company owed the bank $60,000, the full amount of its line of credit. Although the bank had refused to lend Mr. Thomas Benton, the president of the Dearborn Manufacturing Company, $40,000 on his personal secured note, the company had been able, in January, 1933, to reduce its bank debt to $40,000. Early in February it borrowed $30,000 which it repaid within a short period. Later in the same month it obtained an advance of $20,000 for 30 days; it anticipated payment of this loan by about 17 days. In April it borrowed $10,000 more, bringing its total bank debt up to $50,000. This total was represented by three separate unsecured notes: one for $10,000

mentioned just above, and two others for $20,000 each. During the next few months the company found itself unable to reduce its bank debt and consequently renewed all three notes several times. Besides these notes, for two years the bank had held Mr. Benton's personal note for $10,000 for which he would probably request another renewal at the next maturity date.

At the end of July, furthermore, the company owed other unsecured creditors approximately $100,000. Included in this $100,000 were $42,200 of accounts payable; $19,552 of trade acceptances, practically all of which would become payable before the end of August; $27,980 of notes payable, of which $15,350 were payable by December 15, 1933, and $2,080 by March 25, 1934, the rest being demand notes given executives of the company for funds they had put into the business; and about $9,200 of accrued salaries and wages. By the end of July some of the larger of these unsecured creditors had also become somewhat doubtful concerning the ability of the company to meet its obligations, and early in the following month they suggested that the bank should renew its loans of $50,000 until such time as the company could work out of its difficulties.

The officers of the bank realized that about 60% of the company's sales normally were made in the last half of the year, and that, if its already depleted working capital were to be reduced still further, it would probably be unable to finance its operations during the most active season of the year. Moreover, it was probable that the expected increase in the company's volume of business during the fall and winter months would be accompanied by rising prices for its products; and it was possible, therefore, that operations for the entire year might result in net earnings equal at least to those of the first quarter. On the other hand, Mr. Benton had stated as recently as the second week in May that the business probably faced a loss from operations for the period from April 1 to October 1. Such an outcome seemed by no means improbable since the company's costs of production would be increased appreciably by the National Recovery Act, its business was one in which competition was very active, and the demand for its products, particularly puzzles, was somewhat irregular and uncertain. The officers of the Northwestern National Bank, furthermore, had reasons for believing that thé progress of the company was being hampered by differences of opinion among its executives, who owned practically all its stock. Finally,

the last audit of the company's books had disclosed the fact that approximately $18,000 of the $52,384 of accounts receivable included among its current assets as of July 31 would probably prove to be uncollectible. In view of all these circumstances the officers of the bank felt that they could not, in fairness to their depositors and stockholders, agree to extend the maturity of the company's notes indefinitely, as was suggested, and thus in effect subordinate their claims to those of the other unsecured creditors.

Balance sheets and operating statements of the company are shown in Exhibits 1 and 2.

What action should the Northwestern National Bank have taken with respect to the three loans of the Dearborn Manufacturing Company?

EXHIBIT 1
DEARBORN MANUFACTURING COMPANY
BALANCE SHEET

Item	Dec. 31, 1931	Dec. 31, 1932	Mar. 31, 1933	June 30, 1933	July 31, 1933
ASSETS					
Cash	$ 10,520	$ 14,382	$ 47,270	$ 11,886	$ 7,816
Accounts Receivable	52,042	128,680	108,316	76,334	52,384
Notes Receivable*	6,518	2,800	2,520	8	
Trade Acceptances Receivable	....	....	3,556		
Merchandise Inventory	101,402	90,554	138,298	148,662	150,442
Cash Surrender Value of Life Insurance, Less Loans†	2,838	2,080	2,080	1,088	
Prepaid Expenses	9,328	8,100	1,850	8,410	
Total Current Assets	$182,648	$246,596	$303,890	$246,388	$210,642
Investments	426	800	1,300	1,750	2,838
Land and Buildings	67,364	65,580	69,976	69,976	69,976
Machinery and Equipment	236,162	204,036	271,572	271,728	271,728
Office Equipment	3,852	3,270	4,354	4,354	4,354
Prepaid Royalties	....	....	....	....	9,228
Prepaid Commissions	....	....	....	....	884
Deferred Charges	17,464	18,308	18,310	18,310	12,972
Goodwill	2,000	2,000	2,000	2,000	2,000
Total Assets	$509,916	$540,590	$671,402	$614,506	$584,622
LIABILITIES					
Accounts and Acceptances Payable	$ 32,922	$ 87,440	$120,208	$ 57,790	$ 61,752
Notes Payable—Bank	40,000	60,000	40,000	50,000	50,000
Notes Payable—Others	40,136	30,602‖	27,972	25,004	27,980
Accrued Expenses	8,056	10,086	2,094	3,248	9,612
Provision for Taxes	630	190	190	1,140	1,458
Total Current Liabilities	$121,744	$188,318	$190,464	$137,182	$150,802
Machinery Sold	....	....	....	2,020	
Mortgages Payable	32,000	29,800	28,600	28,400	28,400
Reserve for Depreciation	....	....	55,714	64,444	67,352
Reserve for Bad Debts	....	....	11,456	11,456	
Reserve for Deferred Charges	....	....	2,286	4,574	
Preferred Stock‡	391,200	391,200	391,200	391,200	391,200
Common Stock§	2,118	2,118	2,118	2,118	2,118
Deficit	37,146	70,846	10,436	26,888	55,250
Total Liabilities	$509,916	$540,590	$671,402	$614,506	$584,622

* Less notes discounted amounting to $11,936 as of December 31, 1931.

† Loans of $10,044 as of December 31, 1931; $13,666 as of December 31, 1932, and March 1, 1933; and $14,658 as of June 30 and July 31, 1933.

‡ 3,912 shares—7%, cumulative, $100 par. Accumulated dividends on this stock as of June 30, 1933, amounted to 12½%.

§ 4,314 shares, no par value.

‖ $12,350 of this amount represented loans to the company from its executives.

EXHIBIT 2
DEARBORN MANUFACTURING COMPANY
INCOME ACCOUNT

Item	7 months ended Dec. 31, 1931	Year ended Dec. 31, 1932	3 months ended Mar. 31, 1933	6 months ended June 30, 1933	7 months ended July 31, 1933
Net sales	$518,038	$628,480	$363,208	$470,838	$505,534
Cost of sales*	404,582	487,516	249,836	329,920	378,472
Gross profit	$113,456	$140,964	$113,372	$140,918	$127,062
Less depreciation	....	......	11,008	22,026	
			$102,364	$118,892	
Operating expenses*:					
Delivery	18,626	21,200	5,626	9,844	16,142
Selling	35,188	37,550	18,230	27,536	30,226
Administrative	59,042	56,536	16,740	34,752	40,798
Total operating expenses	$112,856	$115,286	$ 40,596	$ 72,132	$ 87,166
Net income from operations	600	25,678	61,768	46,760	39,896
Other expenses less other income*	34,512	60,702	1,358	2,802	12,622
Net profit	$ 33,912[d]	$ 35,024[d]	$ 60,410	$ 43,958	$ 27,274

* Depreciation charges are included in cost of sales, operating expenses, and other expenses less other income for 1931, 1932, and the seven months ended July 31, 1933.
[d] Deficit.

6. TEXICAN PRODUCTION COMPANY[1]

BANK LOANS SECURED BY STORED OIL[2]

In November, 1927, officials of the Texican Production Company believed that oil prices were probably as low as they would be for some time and consequently wished to store part of the company's production. Since the financial position of the Texican Production Company was not strong enough to permit advantageous sale of bonds to the public, the management asked the Hampden National Bank of St. Louis for a $1,000,000 loan to be secured by oil at 80% of its daily posted price and by a mortgage on the storage tanks themselves, on the ground occupied by the tanks, and on gathering pipe lines.

The Texican Production Company purchased and developed proved acreage and then sold it to large producing and refining companies. The total output of the Texican Production Company, approximately 15,000 bbl. a day, was largely from wells required to offset new drilling developments by the Gulf Oil Corporation, although the Texican Production Company officials were anxious to keep production at a minimum. The company's chief property in Texas was crossed by four pipe lines, and the Pinckney Petroleum Corporation was reported to be planning to build another within a year.

In the spring of 1926 the Texican Production Company had sold acreage to the Finlay Petroleum Company for $3,500,000 in cash and 20% of the profits from oil taken from that field after the Finlay Petroleum Company had recovered its original investment. This percentage contract was carried on the balance sheet at $2,157,266, which was 20% of the estimated value of oil in the land less its estimated production costs; oil accountants customarily valued percentage contracts in this way. The Texican Production Company also had sold a one-half interest in a lease in Texas to the Pinckney Petroleum Corporation for $700,000; the two companies in November were operating this territory jointly.

The Texican Production Company, a closed corporation, had been organized in 1923. Although it had incurred a deficit for

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

[2] Extension of bank credit to oil producers and refiners is discussed in E. B. Schwulst, *Extension of Bank Credit*, pp. 220–234.

the fiscal year ending December 31, 1926, it had an operating profit of $233,670 for the four months ending April 30, 1927. In November, 1927, the company had a $1,000,000 credit line with an oil supply company from which it purchased materials and tanks. This loan was secured by stored oil and tanks. The company's balance sheet is given in Exhibit 1.

EXHIBIT 1
TEXICAN PRODUCTION COMPANY
BALANCE SHEET, AS OF APRIL 30, 1927

Assets		Liabilities	
Cash	$ 165,995	Notes Payable	$ 150,000
Accounts Receivable	1,045,934	Cash Vouchers Payable	77,857
Notes Receivable	307,300	Payrolls	3,913
Accrued Interest Receivable	128	Deferred Income—Seaman Producing Company Contract	137,078
Materials	28,054	Finlay Petroleum Company Contract (Contra)	2,157,266
Life Insurance at Cash Surrender Value	4,781	Contingent Accounts Payable	43,100
Prepaid Insurance	5,114	Due Seaman Producing Company	38,954
Deposits	405	Surplus	1,770,267
Funds in Escrow	3,165		
Contractual Receivables with Seaman Producing Company from Oil Produced	127,078		
Stock in Other Companies	2,500		
Deferred Items	4,269		
Valuation of Properties Operated under Contract with Finlay Petroleum Company	2,157,266		
Leasehold Bonuses Payable from Oil Produced	43,100		
Fixed Assets	480,641		
Organization Expenses	2,705		
Total Assets	$4,378,435	Total Liabilities	$4,378,435

On account of its inferior quality and high sulphur content the company's West Texas oil was quoted at about half the price of 33 to 33.9° gravity Seminole district crude petroleum, the decline of which was representative of the oil industry (see Exhibit 2). Although there was still a maladjustment between production and consumption, as shown in Exhibit 3, the Texican Production Company management was hopeful that the oil industry had been through the most acute period of the depression and that as conditions slowly improved the price of all grades of oil would rise.

The notes were to be issued under a trust agreement and were to bear interest at 6%; a commission of 5% was to be paid to the bank as the money was withdrawn. The borrower was obligated to take the first $600,000 of the line but not the last $400,000. The loan was to be not more than 80% of the value of stored oil at the prices posted by the pipe-line companies. The oil in storage as of November 10, 1927, was valued at $636,120 at current market price and the tanks at $493,000. If the Texican Production Company sold the other half of the lease which it owned with the Pinckney Petroleum Corporation, it agreed to devote the proceeds to liquidating the loan. As the pledged oil was drawn from the tanks and sold, the proceeds were to be used to liquidate the company's obligation. The Texican Production Company further was to insure the oil against fires and tornadoes and to pay the expenses of a trustee who would gauge the oil periodically.

The Hampden National Bank consulted several men who knew the Texican Production Company officials. A vice president of a Fort Worth bank spoke highly of the integrity of the officials, as did the vice president of another Texas bank whose officers frequently had endorsed the Texican Production Company's notes. The latter, however, stated that since much of the oil in Texas had a high sulphur content it had a tendency to injure the storage tanks.

An executive of the Pinckney Petroleum Corporation, however, stated that the Texas oil was of satisfactory quality. He added that on account of its joint operation of the lease the Texican Production Company would have first use of the Pinckney Petroleum Corporation's proposed pipe line when completed. The Pinckney Petroleum Corporation, moreover, was willing to act as trustee, to gauge the oil in storage twice a month, and to keep the Hampden National Bank informed regarding prices.

The executives of the Hampden National Bank were convinced that the Texican Production Company officials were of good character, an important consideration in loans of this type, since despite the vigilance of the trustee it might be possible to drain the oil or in other ways defraud the creditor. They realized, however, that a large part of the Texican Production Company assets were accounts receivable, oil lands, and percentage contracts. The value of either the land owned in fee or the percentage contracts depended on the oil reserves, which were

difficult to gauge. Furthermore, the Texican Production Company had been operating only about five years and depended for its profit largely on the sale of developed acreage. Such transactions might yield large profits at times; the Texican Production Company, however, did not have the comparatively steady sales volume of companies engaged primarily in selling crude oil or refined products.

Moreover, while oil prices were lower than for several years, crude oil stocks were of unusual size and it was possible that, if production continued in excess of consumption, prices might decline further. The newly discovered fields in the Panhandle and West Texas districts, while still unexploited, offered possibilities of a vast new supply of oil, with a consequent further depression of prices. Much of the Texas oil acreage either was inadequately served by pipe lines or had no transportation facilities. The fact that the relatively few large companies that owned much of the Texas acreage were cooperating to prevent a further decline in prices had averted severe competition in drilling. It was also questionable to what extent storage of oil was desirable, since it involved an annual expense of 40 cents per barrel, including tank construction costs and carrying charges.

Should the Hampden National Bank have made the proposed loan to the Texican Production Company?

7. ATLAS MANUFACTURING COMPANY

APPLICATION FOR INCREASED LINE OF CREDIT

In January, 1934, the treasurer of the Atlas Manufacturing Company requested the San Antonio National Bank, its chief depository, to increase the company's line of credit from $250,000 to $400,000. He explained that, since prospects for a larger volume of business in 1934 made it desirable to increase the company's aggregate credit lines from $500,000 to $800,000, he was asking each of the company's four depositories to grant a 60% increase over the line in force during 1933.

The Atlas Manufacturing Company was a Texas corporation, organized in 1905 to manufacture and distribute stationery, school supplies, greeting cards, and allied products. Although essentially a converter, the company produced in its own factories a small percentage of the paper which it used. Home office and principal plant were located in San Antonio; smaller mills were situated in several towns in adjacent states. Atlas products, distributed directly to retailers as well as through jobbers, were sold by stationers, department stores, and other retail outlets throughout the United States.

The Atlas Manufacturing Company, in common with other concerns in this branch of the paper industry, made the major part of its annual sales during the early fall months. Consequently it required considerable seasonal financing to carry inventories and receivables. The company customarily began to borrow from banks in January, indebtedness of this type reaching a maximum in July and August, when inventories were at their annual peak. With the reduction of inventories and the liquidation of accounts receivable in the following months, bank loans were decreased, and a seasonal "clean-up" was effected in December or early January. For several years on account of prevailing conditions this clean-up had been accomplished with difficulty or not at all.

The San Antonio National Bank had handled profitably for many years the pay-roll account for the local plant of the Atlas Manufacturing Company. Because of satisfactory relations in the past and because of the importance of the Atlas plant as an employer of local labor, the officers of the bank were extremely reluctant to refuse the requested increase in the company's line

of credit. Nevertheless, they were not wholly convinced that it would be sound financial policy for the Atlas Manufacturing Company to depend upon further bank loans for the additional working capital it wished to raise.

The treasurer of the company had informed the officers of the bank that he was considering the advisability of securing a portion of the necessary seasonal financing in the open market. On several occasions before 1930 the company had borrowed funds in this manner. Not only was the treasurer attracted by the possibility of securing funds more cheaply than could be done by means of bank loans for which the company was paying 5½% per annum, but also he was convinced that for a firm in the stationery business the advertising given by open-market financing would be of value.

Additional information on the financial position of the company is given in Exhibits 1 and 2. Exhibit 3 shows weekly commercial paper rates for the two months preceding January 20, 1934.

1. Should the San Antonio National Bank have granted the requested increase in the credit line of the Atlas Manufacturing Company?

2. Should the Atlas Manufacturing Company have attempted to replace a portion of its bank lines by open-market borrowing?

3. Would the paper of this company have found a ready market among banks? What rating should be given to the company's paper?

EXHIBIT 1
ATLAS MANUFACTURING COMPANY
BALANCE SHEET,* AS OF DECEMBER 31

Item	1930	1931	1932	1933
ASSETS				
Cash	$ 94,621	$ 125,965	$ 129,092	$ 59,576
Notes and Accounts Receivable	201,308	230,450	121,547	113,387
Inventories	680,810	434,432	329,030	408,477
Cash Value of Life Insurance	167,034	104,398	112,713	119,837
Deposits, Mutual Insurance Company	20,355	18,478	15,936	10,295
Total Current Assets	$1,164,128	$ 913,723	$ 708,320	$ 711,572
Plant and Equipment	1,007,340	1,026,512	892,273	835,423
Investments	7,047	7,047	5,040	3,230
Other Notes and Accounts Receivable	12,659	11,996	9,493	7,242
Prepaid Items	46,233	34,960	18,769	11,319
Total Assets	$2,237,407	$1,994,238	$1,633,895	$1,568,786
LIABILITIES				
Payable to Banks	$ 279,300	$ 267,900	$ 179,550	$ 42,750
Accounts Payable	30,115	48,401	54,103	99,924
Accrued Items and Reserves	3,390	5,629	723	18,903
Mortgage Payable—Current	12,774	7,074		
Life Insurance Policy Loans	....	....	28,500	107,012
Total Current Liabilities	$ 325,579	$ 329,004	$ 262,876	$ 268,589
Real Estate Mortgages	69,773	51,300	46,740	42,180
Preferred Stock, 7%	714,210	712,272	711,132	709,992
Common Stock, No Par†	747,384	747,384	747,384	393,625
Surplus	380,461	154,278	134,237[d]	154,400
Total Liabilities	$2,237,407	$1,994,238	$1,633,895	$1,568,786

* Audited.
† Changed to $5 par value in 1933.
[d] Deficit.

EXHIBIT 2
ATLAS MANUFACTURING COMPANY
INCOME STATEMENT,* YEARS ENDED DECEMBER 31

Item	1930	1931	1932	1933
Net sales	$2,280,000†	$2,060,612	$1,486,724	$1,151,176
Gross profit	....	210,583	269,148	237,164
General and selling expenses	....	440,123	418,594	328,115
Operating loss	....	$ 229,540	$ 149,446	$ 90,951
Other income	....	4,338	4,147	31,671
Charges against income	....	23,632	25,468	38,366
Net loss	$ 88,692	$ 248,834	$ 170,767	$ 97,646
Preferred dividends	50,100	24,963		
Common dividends	23,092			
Adjustments	....	cr. 49,893	dr. 119,666	

* Audited.
† Approximate.

EXHIBIT 3
COMMERCIAL PAPER RATES

Date	Prime names		Lesser known names
	3 to 4 months	4 to 6 months	3 to 6 months
November 18, 1933	1¼	1½	1¾
November 25, 1933	1¼	1½	1¾
December 2, 1933	1¼	1½	1¾
December 9, 1933	1¼	1½	1¾
December 16, 1933	1¼	1½	1¾
December 23, 1933	1¼	1½	1¾
December 30, 1933	1¼	1½	1¾
January 6, 1934	1¼	1½	1½
January 13, 1934	1¼	1½	1½
January 20, 1934	1¼	1½	1¾

Source: *New York Times.*

IV

DIVIDEND POLICY AND RELATED PROBLEMS

1. HARBOARD WIRE PRODUCTS CORPORATION

DIVIDEND POLICY DURING PERIOD OF DECLINING EARNINGS

At the close of its first quarter's operations in 1932 the Harboard Wire Products Corporation reported earnings of $5,573 after all charges, equal to approximately 1 cent a share on 412,500 shares of no-par common stock outstanding. The stock had been reduced to a $1 per year dividend in January, 1932, and the regular quarterly dividend of 25 cents was declared April 1, 1932. Two months later, with the stock selling at around $3 per share to yield 33⅓%, Mr. Harboard, president of the corporation, predicted the payment of the regular dividend in July and on succeeding dividend dates in 1932.

As quoted by a financial journal, Mr. Harboard said:

> Based on current operations[1] and business booked for the future, I do not anticipate the need for drawing upon our cash surplus to maintain the present dividend rate. We have maintained the strong financial position with which we began the current year when cash and government securities totaled $1,378,261. With a long-established business such as ours, this is ample for our requirements. I do not foresee any unusual expenditures, either for buildings or equipment, or for other purposes.
>
> This is no time for hoarding cash, and, inasmuch as we expect to earn the dividend, I see no reason for not continuing to pay it. The dividend policy has the unanimous approval of directors and the endorsement of a majority of stockholders.

The company's plants were operating on a five-day week at the time of this announcement.

The Harboard Wire Products Corporation was incorporated in 1918 to take over a business established in 1898. The company entered upon a period of expansion in 1922 by purchasing the entire common stock of several concerns manufacturing wire products. In 1931 the Harboard corporation owned nine plants,

[1] During April and May, 1932, earnings were at the rate of 56 cents per share per year.

normally employing over 2,000 persons and manufacturing a diversified line of wire products including coat hangers, bed springs, automobile cushion springs, and coiled and woven springs of every description. It was estimated by a trade journal that in 1928 the company furnished over 70% of the requirements of the country for automobile cushion springs. For the most part, the plants were located in the Middle West, but the company owned some subsidiaries which operated in the South and on the West coast.

In June, 1926, Bates and White,[1] a New York investment banking house, brought out for the Harboard corporation a $1,000,000 issue of 5½% first mortgage serial gold bonds, callable at 102. The bond maturities were as follows:

June 1, 1927	$ 85,000	June 1, 1932	$100,000
June 1, 1928	85,000	June 1, 1933	100,000
June 1, 1929	85,000	June 1, 1934	100,000
June 1, 1930	85,000	June 1, 1935	100,000
June 1, 1931	100,000	June 1, 1936	160,000

In announcing these bonds, the bankers called attention to the fact that the Harboard corporation had financed its expansion up to that date solely by reinvestment of earnings. The same bankers offered 75,000 shares of cumulative convertible preferred stock in March, 1928. However, it was reported in the *Wall Street Journal* that this did not represent new financing. This issue of preferred stock was redeemed or converted into common stock before October, 1928, when application was made to the New York Stock Exchange for listing of 330,000 shares of common. In August, 1929, the authorized shares were increased to 1,000,000, and application was made to list an additional 82,500 shares which were issued so that a 25% stock dividend might be declared.

Exhibit 3 indicates that the company had maintained an unbroken dividend record from 1924, although disbursements, in line with fluctuating profits, had been made at varying rates. Common share earnings had declined from $5.36 in 1929 to $1.26 in 1931. First-quarter earnings of 1932 were at the rate of 1 cent per share as compared with 60 cents per share for the first quarter of 1931. Despite this decline in earning power, the president was able to point out that the book value of the stock decreased only from $19.99 a share in 1930 to $19.07 a share at the end of 1931.

[1] Mr. Jones, a partner of Bates and White, was also a director of the Harboard corporation.

1. What action should the directors have taken in June, 1932, with regard to the payment of dividends for the second quarter?

2. Was it sound financial policy to pay dividends of 25 cents a share in April, 1932?

EXHIBIT 1
HARBOARD WIRE PRODUCTS CORPORATION
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	March 31, 1926	1927	1928	1929	1930	1931
ASSETS						
Cash	$ 14	$ 397	$1,611	$ 1,035	$ 849	$ 545
Call Loans and Demand Loans	......	......	... ..	1,147	696	833
U. S. Government Securities	......	......	200			
Accounts and Notes Receivable, Less Reserve	1,182	724	1,224	1,088	587	599
Cash Surrender Value of Life Insurance	31	49	56	76	77	5
Inventories	876	1,006	1,358	1,204	1,023	804
Total Current Assets	$2,103	$2,176	$4,449	$ 4,550	$3,232	$2,786
Employees' Notes and Accounts Receivable	......	......	......	....	318	287
Officers' Call Loans	......	......	......	....	740	720
Prepayments and Bond Discount	50	146	141	158	182	165
Sinking Fund	......	54	53	53	61	61
Treasury Common Stock	......	......	......	698	547	547
Investments and Miscellaneous	92	50	120	39	36	31
Goodwill and Patents	587	577	528	479	275	275
Land, Buildings, and Equipment, Less Depreciation	3,756	3,986	3,989	4,029	3,909	3,715
Total Assets	$6,588	$6,989	$9,280	$10,006	$9,300	$8,587
LIABILITIES						
Notes Payable—Banks	$ 370					
Accounts Payable	222	$ 123	$ 155	$ 57	$ 127	$ 171
Dividends Payable	......	132	248	297	291	97
Accruals	196	164	469	325	218	134
Total Current Liabilities	$ 788	$ 419	$ 872	$ 679	$ 636	$ 402
Funded Debt	.....	915	830	642	415	314
Capital Stock	3,679	3,525	4,515	5,588	5,588	5,588
Earned Surplus	2,121	2,130	3,063	3,097	2,661	2,283
Total Liabilities	$6,588	$6,989	$9,280	$10,006	$9,300	$8,587

EXHIBIT 2

HARBOARD WIRE PRODUCTS CORPORATION

CONSOLIDATED INCOME ACCOUNT AND SURPLUS ACCOUNT, YEARS ENDED DECEMBER 31

(In thousands of dollars)

Item	1926	1927	1928	1929	1930	1931	First quarter, 1932
INCOME ACCOUNT							
Gross income	$ 9,869	$ 9,592	$ 13,187	....	$ 10,836		
Less:							
Operating expense and depreciation	8,829	8,569	11,175	....	9,529		
Operating income	$ 1,040	$ 1,023	$ 2,012	....	$ 1,307	....	$ −32
Other income	124	116	179	....	197	....	43
Total income	$ 1,164	$ 1,139	$ 2,191	$ 2,549	$ 1,504	$ 626	$ 11
Less:							
Interest	98	81	68	47	37	36	5
Miscellaneous charges	....	....	....	19	....	....	
Federal taxes	148	131	247	270	172	68	
Total deductions	$ 246	$ 212	$ 315	$ 336	$ 209	$ 104	$ 5
Net income	918	927	1,876	2,213	1,295	522	6
Less:							
Preferred dividends	....	....	75				
Common dividends:							
Stock	....	....	....	1,072			
Cash	540	532	799	1,102	1,167	874	
Balance of income after dividends	$ 378	$ 395	$ 1,002	$ 39	$ 128	$ −352	
Number of common shares	225,000	225,000	330,000	412,500	412,500	412,500	412,500
Earned per common share	$3.25	$3.28	$5.46	$5.36	$3.14	$1.26	$0.01
SURPLUS ACCOUNT							
Surplus at beginning of year	....	$ 1,735	$ 2,130	$ 3,063	$ 3,097	$ 2,661	
Balance of income after dividends	....	395	1,002	39	128	−352	
Profit on trading in treasury stock	....	....	....	....	42		
Total	....	$ 2,130	$ 3,132	$ 3,102	$ 3,267	$ 2,309	
Less:							
Write-off of patents	....	....	....	....	204		
To reduce 24,302 shares treasury stock to market	....	....	....	....	404		
Federal tax adjustment	....	....	8	....	−2	4	
Miscellaneous adjustments	....	....	61	5	....	22	
Total deductions	....	....	$ 69	$ 5	$ 606	$ 26	
Surplus at end of year	....	$ 2,130	$ 3,063	$ 3,097	$ 2,661	$ 2,283	

EXHIBIT 3
HARBOARD WIRE PRODUCTS CORPORATION
RECORD OF DIVIDENDS ON COMMON STOCK

1924	$1.20
1925	2.50
1926	2.00
1927	2.00
1928	2.50
1929	3.00 + 25% Stock
1930	3.00
1931	2.75

EXHIBIT 4
HARBOARD WIRE PRODUCTS CORPORATION
PRICE RANGE OF COMMON STOCK

Date	Low	High	Date	Low	High
1928	53⅛	62⅝	1932:		
1929	33½	59¾	January	7⅞	8¼
1930	19	47	February	7⅞	9¼
1931:			March	7	9½
January	22⅜	24¾	April	4¾	7⅜
February	22½	29	May	3⅛	4
March	22½	27⅛	June	3	5½
April	18¼	23			
May	14½	20			
June	15	20¾			
July	18	19			
August	16	17¾			
September	14	16¼			
October	13	14¼			
November	13	14⅞			
December	6	11⅝			

2. PORTER BELTING COMPANY

RESUMPTION OF PREFERRED DIVIDENDS

Because earnings for the year 1933 were over $15 a share on the 20,549 shares of 7% cumulative preferred stock outstanding and first quarter earnings for 1934 had continued at about this level, the directors of the Porter Belting Company were considering in May, 1934, the advisability of declaring dividends on the company's preferred stock (see Exhibits 1 and 4). No preferred dividends had been paid after February 15, 1931, with the result that accumulated dividends amounted to $19.25 per share at this time. The company had declared no dividends on the common stock since its incorporation.

The Porter Belting Company, a Massachusetts corporation with its main plant in Boston, was incorporated in 1926 as successor to the long-established Porter Manufacturing Company which had undergone a reorganization at that time. The company tanned hides and from them manufactured leather belting, automotive leathers, packing leathers, sole leathers, and various other leather goods. During the past decade the company had widened its line of products to include mechanical rubber goods, but leather belting continued to be its major product. To protect its market for leather belting, extensive research was carried on.

Since 1927 more than half the company's capital had been invested in current assets (see Exhibit 1). Working capital requirements were normally heavy on account of the long manufacturing period required to convert hides into leather. Furthermore, the definite need for high-grade leathers combined with the scarcity of grade A hides made it compulsory to purchase suitable raw material as it came on the market, irrespective of the current trend of hide prices. (Exhibit 3 shows the trend of hide prices over a period of several years.) The heavy inventory, which was constantly carried by the company in consequence of these conditions, could be either a source of profit or loss depending upon fluctuations in hide prices. The impossibility of a rapid adjustment in the prices of finished leather products with changes in hide prices accentuated the risks involved in this large inventory investment.

In commenting upon operations for the year 1933, the president of the Porter Belting Company made the following statements:

> The very definite change to a profit as compared with losses of previous years has been due not only to increased volume of sales but to continued reductions made in operating expenses.
>
> Our inventory has been increased, owing both to the increase in dollar value of raw materials and to the increase in sales, and also to our belief that cash could be better invested in merchandise than accumulated in the banks. We therefore have a larger inventory than we would ordinarily carry, which can be turned into cash as the volume of business and price advances warrant. The advance in raw-material prices during 1933 has justified that belief. The book value of our inventory is considerably less than current market values, as is indicated by the figures in the accompanying balance sheet. [See Exhibit 1.]

In support of their position that some cash distribution should be made to the holders of the preferred stock, several directors of the company pointed out that (1) working capital was more than adequate; (2) bank loans had been only for seasonal needs and had been liquidated promptly when due; (3) ample lines of credit had been granted by local banks; (4) bond interest was earned over six times in 1933; and (5) retirement of bonds according to sinking fund provisions had been carried out every year.

The company's treasurer, however, called to the attention of those directors who favored a dividend payment the fact that net tangible assets were less than $5,250,000. According to a provision in the mortgage securing the company's 5½% bonds due in 1947, if net tangible assets should fall below this sum, the trustee under the mortgage could declare the bonds due and payable (see Exhibit 5). The following table indicates the amount of the deficiency at the end of 1933.

Item	1931	1932	1933
Tangible Assets	$5,981,194	$4,701,585	$5,416,603
Less: Current Liabilities	385,137	114,015	442,537
	$5,596,057	$4,587,570	$4,974,066
Required Amount	5,250,000	5,250,000	5,250,000
Deficiency	None	$ 662,430	$ 275,934

The treasurer was of the opinion, nevertheless, that slightly more than the required $5,250,000 of net tangible assets could be

shown, as of May, 1934, if the December, 1933, balance sheet figures were adjusted to include the liquidation of bank debt and the valuation of inventories at current market prices.

1. Should the directors of the Porter Belting Company have declared a preferred dividend payment in May, 1934?

2. If so, should the regular quarterly dividend have been declared, or should accrued dividends have been reduced, and by what amount?

3. Assuming that the "net tangible assets" provision in the bond indenture could be removed,[1] would a dividend payment have been expedient?

[1] " . . . the Trustees may at any time, upon the written request of a majority in aggregate principal amount of the Bonds at the time outstanding, waive any default hereunder and its consequences, except a default in the payment of principal or interest of any of the Bonds when and as the same shall become due and payable by the terms thereof."—Mortgage Indenture, Sec. 55.

EXHIBIT I
PORTER BELTING COMPANY
CONDENSED CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932	1933
ASSETS					
Cash	$ 436,805	$ 84,751	$ 110,375	$ 173,601	$ 73,102
Receivables	855,749	675,551	352,112	308,562	371,061
Inventories—Lower of Cost or Market	3,587,187	4,113,877	3,350,534	2,254,816	3,116,227†
Total Current Assets	$4,879,741	$4,874,179	$3,813,021	$2,736,979	$3,560,390
Miscellaneous Investments	84,373	68,303	39,280	26,540	53,101
Mortgage Notes Receivable	51,500	49,754	47,875	22,325	13,022
Loans to Officers and Employees	16,138	21,281	13,421	9,569	12,082
Long-term Notes Receivable	49,000	73,501	80,678	57,520	26,374
Investment in Porter Belting Company, Ltd.	40,000	127,041	87,841	41,283	43,230
Fixed Assets (Net)	1,908,729	1,847,581	1,739,238	1,659,589	1,578,106
Deferred Charges	168,271	165,071	159,840	147,780	130,298
Total Assets	$7,197,752	$7,226,711	$5,981,194	$4,701,585	$5,416,603
LIABILITIES					
Bank Loans	....	$ 325,000	$ 225,000	....	$ 225,000
Trade Acceptances Payable	....	187,174	24,866	....	24,999
Accounts Payable, etc.	$ 338,777	16,625	13,125	$ 114,015	181,538
Reserve for Federal Income Tax	....	220,163	122,146	....	11,000
Total Current Liabilities	$ 338,777	$ 748,962	$ 385,137	$ 114,015	$ 442,537
First Mortgage Bonds, 5½s, 1947	1,394,500	1,365,000	1,291,500	1,212,000	1,197,000
Preferred Stock, 7 % Cumulative*	2,064,560	2,064,560	2,064,560	2,056,560	2,056,560
Common Stock*	1,040,325	1,040,325	1,040,325	1,037,875	1,037,875
Reserve for Contingencies	....	....	....	....	90,000
Capital Surplus	1,961,219	1,961,219	1,961,219	1,966,601	281,134
Earned Surplus	398,371	46,145	761,547[d]	1,685,466[d]	311,497
Total Liabilities	$7,197,752	$7,226,711	$5,981,194	$4,701,585	$5,416,603

* On December 31, 1933, there were 1,623 common stockholders, and 1,728 preferred stockholders.
† Market value, $3,359,984.
[d] Deficit

EXHIBIT 2
PORTER BELTING COMPANY
INCOME STATEMENT, YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932	1933
Sales	$8,941,923	$6,609,065	$4,723,371	$3,085,594	
Profit, after selling and administrative expense, depreciation, etc.	253,162	108,625[d]	213,240[d]	358,136[d]	
Less:					
Inventory price adjustment	53,371	784,194	458,409	484,771	
Interest and Federal taxes	96,841	90,846	99,943	81,012	
Balance	$ 102,950	$ 983,665[d]	$ 771,592[d]	$ 923,919[d]	$401,498
Inventory reserve	cr. 337,895	cr. 776,027			
Contingency reserve	....	....	....	....	90,000
Net income	$ 440,845	$ 207,638[d]	$ 771,592[d]	$ 923,919[d]	$311,498

[d] Deficit.

EXHIBIT 3
WHOLESALE PRICES OF PACKERS' HEAVY NATIVE STEER HIDES AT CHICAGO
(In dollars per pound—average monthly prices)

Month	1926	1927	1928	1929	1930	1931	1932	1933	1934
January....	0.150	0.155	0.261	0.205	0.163	0.095	0.076	0.054	0.101
February...	0.130	0.145	0.248	0.153	0.148	0.073	0 066	0.048	0.103
March.....	0.122	0.140	0.237	0.145	0.142	0.090	0.064	0.052	0 096
April.......	0 114	0.152	0.256	0.149	0.140	0.092	0.050	0.062	0.108*
May......	0 129	0.168	0.246	0.149	0.143	0.085	0.043	0.098	0.102*
June.......	0.133	0 195	0.224	0 168	0.152	0.100	0.043	0.122	
July.... ..	0.142	0.219	0.239	0.181	0.141	0.120	0.049	0.137	
August.....	0.149	0 215	0.236	0.188	0.136	0.113	0.066	0.150	
September.	0.152	0.224	0.246	0.196	0.146	0.090	0 081	0.132	
October ..	0.161	0.233	0.219	0 186	0.133	0.077	0.073	0.103	
November..	0.153	0.242	0.223	0.164	0 118	0.082	0.065	0.103	
December..	0.151	0 250	0 226	0.160	0.107	0 078	0.055	0.099	
Average for the year..	0.141	0.195	0.238	0 170	0 139	0 091	0.061	0 097	

* From the *Shoe and Leather Reporter*, averages of weekly prices.
Source: U. S. Bureau of Labor Statistics.

EXHIBIT 4
PORTER BELTING COMPANY
DESCRIPTION OF 7% CUMULATIVE PREFERRED STOCK

Par value..	$100
Authorized...... .	25,000 shares; outstanding 20,549 shares
Preference....	To assets and cumulative dividends of 7% per annum payable quarterly, February 15, etc.
Callability....	Callable on any dividend date on 3 days' notice at 110 and accrued dividends
Restrictions..... ..	No mortgage may be created and no prior stock may be issued without the consent of holders of 75% of preferred stock outstanding
Voting power.......	Preferred stockholders have no vote, unless unpaid dividends accumulated on the preferred stock after April 1, 1928, aggregate 7%, at which time the entire voting power passes to the preferred stockholders and so continues until dividends have been paid in full, or should have been paid in full, in the exercise of reasonable judgment by the board of directors

EXHIBIT 5
PORTER BELTING COMPANY
SECTION 21 OF THE INDENTURE RELATING TO THE FIRST MORTGAGE 5½% BONDS

As long as any of the Bonds remain outstanding and unpaid, the Company will at all times maintain Net Tangible Assets at an amount at least equal to $5,250,000.

The term "Net Tangible Assets" shall mean the amount by which Tangible Assets shall exceed all liabilities, direct or contingent, other than (1) stock of any class, (2) the aggregate principal amount of Bonds from time to time outstanding hereunder, and (3) the aggregate amount of any and all liabilities (whether existing at the time of the execution of this Indenture or incurred, created, or assumed at any time or times thereafter) specifically and in all respects subordinate and junior to such Bonds.

3. NORRIS MACHINE COMPANY[1]

FINANCIAL PROBLEMS ARISING FROM INCREASED EARNINGS

Under new operating methods and good agricultural conditions the Norris Machine Company had earned $10.64 per share of common stock in 1925 and $20.06 in 1926. In December, 1927, its directors were discussing a number of financial problems arising from this increased prosperity, especially the purchase of preferred stock for the treasury, a possible "split-up" of the common shares, and the common stock dividend policy.

A better relationship between agricultural prices and wholesale commodity prices existed in the fall of 1927 than for several years previous; indexes for these products are shown in Exhibit 1. Cotton, corn, and beef indexes were decidedly better in 1927 than in 1926, and the index of farm products as a whole was higher in relation to the cost of commodities purchased by the farmers. Prosperity in the farming areas was indicated also by the increased sales of the large mail-order houses and the strength in fertilizer-company stocks.

Apparently farm wages, higher in proportion to machinery costs then than in 1914, placed a premium on the use of agricultural implements. The largest use of farm machinery was in the corn belt, since only light implements, manufactured locally, were used in the South. While farm conditions were somewhat improved in 1921 to 1924, sales of agricultural tools were 50% below those of 1914. Hence, a large amount of purchases of replacement as well as of new equipment apparently had been deferred.

The Norris Machine Company had operated for more than 75 years; it manufactured and sold farm machinery of many kinds, including threshing machines, farm steam engines, tractors, steam road rollers, baling presses, silo fillers, and tractor plows and harrows. Distribution was secured through 50 branches in the United States, Canada, and South America, with more than 9,000 local agencies operating in all the important grain-growing areas of the world. The improved financial status of the company is indicated in Exhibits 2 and 3.

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

Regular dividends had been paid on the 7% preferred stock until January 1, 1924. None were paid from then until January 1, 1926, when 7% was declared on the accrued dividend account. The regular quarterly dividend of 1¾% was resumed on April 1, 1926. Another 7% payment on October 1, 1926, retired all accruals. A 7% common stock dividend was paid in Liberty bonds on January 28, 1919, 10% in cash a year later, and none thereafter until April 1, 1927, when a $1.50 dividend was declared.

The preferred stock was entitled to 7% cumulative dividends before payment of dividends on the common stock and to $100 plus accrued dividends in any distribution of the company's assets. The preferred stock had equal voting power with the common, and no common stock dividends could be paid if the assets applicable to dividends as determined by the directors were reduced to less than $2,000,000. The price range of the preferred and common stock was as follows:

Stock	1921	1922	1923	1924	1925	1926	1927
Preferred....	86 to 63	93 to 68	85 to 65	77 to 41	107 to 60	118 to 96	125 to 111
Common.....	....	44 to 29	42 to 17	35 to 14	68 to 24	176 to 62	269 to 132

The management owned enough of both common and preferred stock to be assured of control.

Greater prosperity among the farmers on account of higher grain and cotton prices indicated that earnings would be larger in 1927 than in previous years. Dividends of $10 could be paid on the common stock from 1926 earnings and still leave 50% of the available balance to be added to surplus. The existing dividend at the rate of $6 annually yielded less than 2.3% upon the current price of about $265 a share. Fluctuations in earnings of agricultural-implement companies, however, were wide, since the purchasing power of the farmers varied from year to year. The Norris Machine Company also found it necessary to sell implements to farmers on long-term payments and as a result had a large amount of notes receivable. If on account of low prices for agricultural products farmers were unable to continue payments in the future, repossessions and inventory losses might be heavy and large amounts of the notes receivable might not be paid.

Another plan considered was the purchase of preferred stock for the treasury, thus leaving larger net earnings available for common dividends. Preferred stock so purchased and held in the treasury was carried at $2,296,733 at the end of 1926, compared with $1,183,552 in 1925 and none in 1924. Some stockholders argued that the retirement of the preferred stock was unnecessary since the management already had control and that to pay an increased dividend on the common stock would be preferable. Preferred stock was quoted at about $120, but offerings were small, and heavy buying would doubtless cause an increase of price.

On account of the limited capitalization of 130,000 common shares and the uncertainty regarding earnings, the common stock experienced violent price fluctuations. Some directors advocated a stock split-up, which by reducing the value of the shares and increasing the number would encourage purchases by small investors. The principal arguments against such action were that it might increase speculation and that it was unnecessary.

When preferred dividends were passed in 1924 and 1925, some of the directors thought it unfair to preferred stockholders for the company thus to conserve cash for working capital purposes in preference to utilizing bank credits. Although preferred dividends were cumulative, many investors desired a regular income. Other directors argued that the preferred stockholders would eventually receive their dividends, since the latter were cumulative. In the meantime, however, in these directors' opinion, until the Norris Machine Company's earnings appeared on a relatively stable basis and the current assets position was sound, it was preferable to liquidate bank loans and thereby reduce interest charges.

What policies should the Norris Machine Company have followed in 1927 in regard to the purchase of preferred stock for the treasury, a possible split-up of the common shares, and dividends on the common stock? What dividends should it have paid on the preferred stock in 1925?

EXHIBIT 1

PRICE INDEXES OF FARM PRODUCTS AND WHOLESALE COMMODITIES

Products and commodities	October, 1926	September, 1927	October, 1927
Farm products:*			
Cotton	94	181	169
Corn	116	148	136
Wheat	137	135	129
Hay	110	89	90
Potatoes	181	154	140
Beef cattle	124	143	145
Hogs	167	135	140
Eggs	171	137	166
Butter	164	164	170
Wool	178	175	174
Wholesale commodities:†			
Farm products	139	153	153
Food	151	149	152
Clothes and clothing	175	182	182
Fuel and lighting	214	184	183
Metal and metal products	136	127	126
Chemicals	128	121	121
House furnishing goods	166	163	163
All commodities	152	152	153

* U. S. Department of Agriculture Index, August, 1909, to July, 1914, = 100.
† U. S. Bureau of Labor Statistics Index, 1910 to 1914 = 100.

EXHIBIT 2

INCOME STATEMENTS OF THE NORRIS MACHINE COMPANY, YEARS ENDED DECEMBER 31

Item	1922	1923	1924	1925	1926
Gross sales*	$15,720,716	$18,587,952			
Net operating income†	860,283	1,370,807	$1,512,270	$4,132,820	$4,717,429
Deduct:					
Interest and discount	367,584	405,848	343,367	0	0
Reserves for contingencies	0	0	0	500,000	300,000
Losses from inventory declines	0	0	561,558	0	0
Reserves for depreciation	171,429	330,326	459,634	664,147	0
Reserves for Federal taxes	0	0	0	675,000	900,000
Balance for dividends	$ 321,270	$ 634,633	$ 147,711	$2,293,673	$3,517,429
Preferred dividends	910,000	910,000	0	804,909	787,409
Surplus	$ 588,730[d]	$ 275,367[d]	$ 147,711	$1,488,764	$2,730,020
Earnings per share of common stock	0	0	0	10.64	20.06

* Gross sales were not reported in 1924, 1925, and 1926.
† After interest charges in 1925 and after interest charges and depreciation and inventory reserves in 1926.
[d] Deficit.

EXHIBIT 3

BALANCE SHEETS OF THE NORRIS MACHINE COMPANY, AS OF DECEMBER 31

Item	1922	1923	1924	1925	1926
ASSETS					
Real Estate and Plant	$15,549,836	$15,592,853	$15,406,990	$15,248,839	$15,488,278
Less: Depreciation	3,304,679	3,625,465	3,818,960	4,320,414	5,177,572
Net Real Estate and Plant	$12,245,157	$11,967,388	$11,588,030	$10,928,425	$10,310,706
Patents, Designs, and Devices	1,044,423	1,044,423	1,044,423	1,044,423	1,044,423
Bond Discount and Other Charges	339,337	405,266	264,031	91,489	101,071
Common Stock in Treasury	0	0	241,151	233,165	232,044
Preferred Stock in Treasury	0	0	0	1,183,552	2,296,733
Inventories	12,720,455	11,862,629	10,778,440	8,573,054	10,793,541
Notes Receivable	6,965,055	7,329,209	6,821,829	7,069,048	8,148,183
Accounts Receivable	432,263	343,887	396,679	518,399	547,185
Investments in Subsidiary	276,504	136,803	54,215	0	0
Property Acquired at Foreclosure	103,017	108,197	104,868	91,485	47,054
Cash	683,356	819,615	730,303	2,848,904	1,748,326
Total Assets	$34,809,567	$34,017,417	$32,023,969	$32,581,944	$35,269,266
LIABILITIES					
Common Stock	$13,000,000	$13,000,000	$13,000,000	$13,000,000	$13,000,000
Preferred Stock	13,000,000	13,000,000	13,000,000	13,000,000	13,000,000
Bills Payable	5,395,000	4,975,000	3,200,000	0	0
Accounts Payable	997,194	900,410	834,251	1,123,553	1,278,278
Preferred Dividends Payable	0	0	0	804,909	0
Contingent Losses and Future Collection Expenses	1,000,000	1,000,000	700,000	1,200,000	1,500,000
Industrial Accident Liability	100,000	100,000	100,000	100,000	100,000
Federal Taxes	0	0	0	675,000	1,037,395
Inventory Reserves	0	0	0	0	750,000
Surplus	1,317,373	1,042,007	1,189,718	2,678,482	4,603,593
Total Liabilities	$34,809,567	$34,017,417	$32,023,969	$32,581,944	$35,269,266
Net Working Capital	$14,408,935	$14,479,930	$14,693,000	$16,405,943	$18,921,562

4. AMERICAN AGRICULTURAL CHEMICAL COMPANY

PURCHASE BY COMPANY OF ITS OWN COMMON STOCK

One of the significant developments in the field of corporate finance in the years from 1930 through 1933 has been the widespread extent to which American corporations have followed a policy of purchasing for retirement their common and preferred stocks.[1] In many cases, purchase of their own securities by corporate managements has been stimulated by an extremely liquid condition, the result, wholly or in part, of the large cash holdings carried over from 1929, of decreased working capital requirements, and of the postponement of repairs and replacements even when depreciation charges have been earned. This corporate procedure for reducing capital stock outstanding not only has provoked controversy among security holders but also has raised legal and business problems.

In favor of this practice it has been pointed out that a reduction in outstanding shares results in higher earnings per share and makes possible a more stable dividend policy. Furthermore, with a decrease in the floating supply of the stock, the market price will tend to rise. If the shares are purchased for less than the amount at which they are carried on the balance sheet, the corporation improves its financial position by the transaction.

On the other hand, those who believe that the right of a corporation to purchase its own stock should be restricted argue that creditors are entitled to have assets remain in the enterprise subject only to the vicissitudes of the business. If shares are purchased in the open market, opponents of the practice allege, corporate funds may be used to buy out insiders at artificially high prices. They cite, as an example of further injustices that may arise from the practice, the use of corporate funds to purchase common stock although dividends on the preferred stock are in arrears.

An instance of a company which used its cash funds to retire common stock was the American Agricultural Chemical Company. In April, 1934, the company asked for tenders of stock at not

[1] On June 14, 1934, the New York Stock Exchange reported that 150 companies had reacquired shares of preferred and common stock. The compilation included only those companies listed on the New York Stock Exchange which had reacquired 5,000 or more shares.

exceeding $35 a share in an amount sufficient to exhaust up to $3,000,000. It was stipulated "that no tender will be accepted except subject to the prior acceptance of all eligible tenders at a lower price and in the event that eligible tenders at the same price cannot all be accepted, they shall be scaled down pro rata." Notwithstanding that this company had no senior security holders whose interests might be impaired if the company purchased its own common stock, its method of acquiring the stock aroused the opposition of some of the common stockholders.

Engaged primarily in the manufacture and sale of mixed fertilizers, the American Agricultural Chemical Company also manufactured and distributed related chemical products, such as sulphuric acid, di- and trisodium phosphate, and insecticides. In 1932 the company began to manufacture tin tetrachloride used by the textile industry in weighting silk. The company's markets included all important agricultural areas east of the Rocky Mountains, although the Middle West and South were its principal areas of operation. For serving these markets the company operated 26 fertilizer-manufacturing plants located throughout the Eastern, Southern, and Middle Western states. Its three chemical manufacturing plants were situated at Detroit, Baltimore, and Carteret, New Jersey. Of the raw materials required, the company obtained phosphate from its own quarries in Florida; nitrates, both synthetic and natural, as well as the sulphur and potash necessary for its fertilizer products, the company purchased from outside sources.

In June, 1930, to remove a serious capital impairment, the American Agricultural Chemical Company was reorganized, and its plant and mining properties were written down by some $10,800,000 and $12,000,000, respectively. In the decade before 1930, earnings of the predecessor company were erratic, varying from a deficit of $11,158,000 in 1921 to a net income of $2,238,000 in 1928. By the time of the reorganization, dividends on the preferred stock, accumulated from 1921, amounted to about $58 a share. In 1931 and 1932, moreover, the new company experienced large deficits, but in 1933 the business of the company improved, and the deficit was considerably reduced. During the year cash increased from $3,632,803 to $5,201,959, the result chiefly of a moderate operating profit before noncash charges and the liquidation of receivables and inventories in the amount of $1,240,000.

After the company's announcement in regard to the purchase of stock, Mr. W. H. Crow, one of its stockholders, requested other stockholders to join him in a protest against the methods of the company's management in acquiring stock. He asserted that the company's stock tender proposal "is in entire disregard of rights and aims of the average stockholder, who will presently find himself cut out of his fair distributive share in a large amount of cash, with little to show for it." He also made the following proposals:

> Fair and equitable distribution of at least $3,000,000 in idle cash for the use and benefit of all stockholders, such distribution to be made on the basis of a dividend of $10 a share or pro rata purchase by the company from all stockholders of 20% of the stock now outstanding, or about 60,000 shares at the uniform price of $50 a share.

In reply to Mr. Crow's letter, on May 10, 1934, the company sent to its stockholders a letter defending its plan. The company's letter read, in part, as follows:

> The funds which the company has to distribute do not represent earned profits but capital realizations. The directors therefore felt it improper to distribute their cash as a dividend but felt that if it was to be distributed it should be used to retire capital liabilities.
>
> Many stockholders of the company have in fact sold their stock during the past year at prices considerably less than the maximum authorized tendered price. It was felt that it would be to the advantage of the stockholders if those stockholders who wanted to sell sold their stock to the company rather than on a lower outside market; and that it would be advantageous to those stockholders who did not desire to sell if the company secured the stock of those who did desire to sell, so as to retire this stock and thereby decrease the number of shares on which a dividend would have to be paid if and when profits would justify payment.
>
> The directors see no justification for offering to buy the stock for $50 a share when the current market price is about $30 a share. If there are stockholders who desire to sell their stock and if the company is in a position to buy stock, the directors feel that in the interests of the stockholders as a whole any purchase should be at or about the market price and not at a price nearly 70% in excess.

Consolidated balance sheets and profit and loss statements of the company are shown in Exhibits 1 and 2; the price range of its common stock is given in Exhibit 3.

1. Was it sound financial policy for the American Agricultural Chemical Corporation to expend $3,000,000 for purchasing its stock in April, 1934?

2. Appraise the company's method for acquiring the stock and the alternative plans offered by the minority group of stockholders.

3. Under what conditions, if any, is a corporation justified in purchasing its common stock for retirement?

4. What are the effects upon owners and creditors (*a*) if a company reduces its outstanding capitalization by purchasing its shares; (*b*) if it writes down the par or stated value of them?

EXHIBIT 1
AMERICAN AGRICULTURAL CHEMICAL COMPANY (DELAWARE)
CONSOLIDATED BALANCE SHEET, AS OF JUNE 30

Item	1931	1932	1933
ASSETS			
Property and Equipment (Net)	$ 5,280,877	$ 4,834,101	$ 4,421,629
Rock Deposits (Net)	1,738,313	1,718,672	1,693,390
Property, Not Used for Operations (Net)	1,166,257	1,015,630	1,039,179
Sundry Investments (Net)	1,313,950	1,269,228	1,142,623
Goodwill, Brand, etc.	1	1	1
Cash	5,978,698	3,632,803	5,201,959
Accounts and Notes Receivable (Net)	8,097,240	5,808,900	5,080,573
Inventories*	5,770,997	3,994,587	3,482,959
Deferred Charges	369,762	395,371	207,004
Sinking Fund	947		
Total Assets	$29,717,042	$22,669,293	$22,269,317
LIABILITIES			
Capital Stock	$12,715,000†	$12,684,840‡	$12,628,040
Capital Surplus	7,744,349	7,764,470	7,813,474
Earned Surplus	698,399	525,658[d]	1,033,785[d]
Bonded Debt§	5,365,500		
Accounts Payable and Accruals	560,837	445,016	478,919
Accrued Interest	172,984		
Reserve for Federal Taxes	84,363		
Reserve for Contingencies	2,280,760	2,281,286	2,361,064
Deferred Credits	94,850	19,339	21,605
Total Liabilities	$29,717,042	$22,669,293	$22,269,317
Current Assets	$19,846,935	$13,436,290	$13,765,491
Current Liabilities	818,184	445,016	478,919
Net Working Capital	$19,028,751	$12,991,274	$13,286,572

* At lower of cost or market.
† Represented by 317,875 no par shares.
‡ 317,875 shares (no par) issued or issuable, including shares reserved for capital stock of predecessor company not yet exchanged, less 754 shares, valued at $30,160 held in treasury.
§ Retired August 1, 1931.
[d] Deficit.
Source: Moody's *Industrials*.

EXHIBIT 2

AMERICAN AGRICULTURAL CHEMICAL COMPANY (DELAWARE)

CONSOLIDATED PROFIT AND LOSS STATEMENT, YEARS ENDED JUNE 30

Item	1931		1932		1933	
Gross profit from operations (after deducting operating, selling, and administrative expenses, and discounts and freights	....	$ 972,049.94	....	$ 147,587.27*	....	$159,841.43†
Deduct:						
Depreciation of plants and depletion of mines	$684,920.58	....	$609,321.82	....	$567,568.64	
Reserves for doubtful receivables	502,745.75	....	325,000.00			
Reserves for insurance	....	1,187,666.33	107,550 54	1,041,872.36	100,400.39	667,969.03
Net loss from operations	....	$ 215,616.39	....	$1,189,459.63	....	$508,127.60
Interest paid and accrued on funded debt	....	566,555.78	....	34,596 88		
Net loss charged to earned surplus account	....	$ 782,172.17	....	$1,224,056.51	....	$508,127.60

* Loss.
† After provision for possible credit losses.
Source: Company reports.

EXHIBIT 3

AMERICAN AGRICULTURAL CHEMICAL COMPANY (DELAWARE)

PRICE RANGE OF COMMON STOCK

Date		High	Low
1931		29¾	5⅛
1932		15½	3½
1933:			
January		10½	9¼
February		8¾	7⅜
March		10⅛	10⅛
April		15⅜	10½
May		20⅝	14½
June		23½	16⅛
July		35	21¼
August		30½	24½
September		32¾	25¼
October		27¼	20
November		25¾	20½
December		26⅞	22
1934, week ending:			
January	6	26¾	25¼
	13	28	25¼
	20	33½	27
	27	36	32½
February	3	35½	33¼
	10	35	30¾
	17	34¾	30½
	24	34⅜	31¼
March	3	30¼	28
	10	29¾	28¼
	17	30	29
	31	27¼	26½
April	7	31½	27¼
	14	31	29¼
	21	34	28¾
	28	33½	32¼
May	5	33⅜	32⅛
	12	34	31⅜
	19	33⅜	32¾
	26	33⅜	32¾
June	2	33	32⅞
	9	34	32¾
	16	33⅝	33
	23	33¼	33
	30	33½	33

Sources: Quotations for 1931, 1932, and 1933 from *Bank and Quotation Record;* quotations for 1934 from *The Annalist.*

5. HENSHAW LINOLEUM COMPANY

DISTRIBUTING PROFITS TO RETIRE STOCK, TO REDEEM BONDS, OR TO RESUME DIVIDENDS ON COMMON STOCK

In July, 1931, the directors of the Henshaw Linoleum Company met to discuss questions of financial policy that arose as the result of the very liquid position of the company's assets at that time. Since 1925 the Henshaw Linoleum Company had paid no dividends on its common stock but had reinvested earnings available for this purpose not only in plant and equipment but in call loans and securities as well. In addition, for over a year the company had been making purchases of its common stock in the open market. In July, 1931, it held 153,937 shares of treasury stock bought at an average price of $19.81 per share (see Exhibit 5).

As a result of this conservative financial policy, cash and cash items were 56% of the total current assets in 1931 (see Exhibits 1 and 2). Inventory was being carried at cost or market, whichever was lower, and a depreciation reserve of over 45% of the plant value had been set up. Although 1930 had been a poor year for the Henshaw Linoleum Company, operations for the first six months of 1931 had been conducted on a profitable basis. If profits could be maintained at the same rate for the last half year, the company would earn $1.23 a share on 820,513 common shares then outstanding.

In view of the excellent financial position of the company and its existing earning capacity, the president recommended to the directors that a cash dividend at the rate of $1.80 per annum should be declared on the common stock. He was also in favor of retiring the common stock held in the company's treasury and of continuing the policy of purchasing the company's common shares in the open market when conditions were favorable for such action. Although in agreement that the common stockholders were entitled to a return on their investment if the company's position warranted it, a minority of the directors favored using any available funds for scaling down the company's funded debt and preferred stock instead of purchasing its common shares.

In common with the household furnishings trade in general, the linoleum industry had been adversely affected by the decline in business activity. The Henshaw Linoleum Company, however, had been a pioneer in the development of automatic machinery

and was equipped to manufacture its several branded products with labor costs probably below those of any of its competitors. Of the principal materials entering into the manufacture of linoleum floor coverings—jute, burlap, asphalt, felt, wood meal, cork meal, and linseed oil—the last mentioned accounted for the largest element in raw material costs (see Exhibits 3 and 4).

Although its large investment in plant and equipment per unit of output made it more profitable to produce only a few standard designs and grades, competition had forced the company to feature style items. National advertising campaigns were carried on under the supervision of a director who was also head of a prominent advertising agency. In its advertising appeal the company stressed the smartness of its designs as well as the quality of its floor coverings. The company distributed its products chiefly through jobbers through whom it reached several thousand retail dealers in the United States. Replacement of worn-out and obsolete floor covering accounted for approximately 85% of its output. With five plants employing 3,500 people when operations were at full capacity, the Henshaw Linoleum Company controlled from one-third to one-half of the total volume of hard floor coverings produced.

What action should the directors of the Henshaw Linoleum Company have taken in July, 1931, with regard to (*a*) the resumption of common stock dividends, (*b*) the retirement of the company's treasury stock, (*c*) the purchase of the company's common stock in the open market, (*d*) the redemption of its bonds and preferred stock?

EXHIBIT 1
HENSHAW LINOLEUM COMPANY
BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1928	1929	1930	June 30, 1931
ASSETS				
Cash	$ 1,018	$ 784	$ 2,037	$ 3,683
Call Loan	4,905	6,660		
Government and Municipal Securities	......	......	5,109	5,696
Notes and Accounts Receivable, Less Reserve	1,984	2,565	2,336	2,740
Inventories	8,156	7,754	6,463	4,224
Sundry Debtors	166	144	195	166
Total Current Assets	$16,229	$17,907	$16,140	$16,509
Investments	1,107	1,690	816	669
Treasury Common Stock, at Cost*	......	......	2,333	3,049
Fixed Assets, Less Depreciation	12,983	12,472	11,997	11,706
Goodwill, Trade-marks, Patents, etc.	901	901	901	901
Deferred Debits	116	95	74	29
Total Assets	$31,336	$33,065	$32,261	$32,863
LIABILITIES				
Current Liabilities (Accounts Payable and Taxes	$ 975	$ 912	$ 397	$ 511
First Mortgage 6% Serial Gold Notes, 1929–1932†	400	300	200	100
First Mortgage 7% Sinking Fund Gold Bonds, 1942‡	1,146	1,146	1,146	1,146
Reserves	910	961	752	852
Preferred Stock, Less in Treasury§	1,358	1,301	1,221	1,204
Common Stock‖	12,379	12,379	12,379	12,379
Combined Surplus	14,168	16,066	16,166	16,671
Total Liabilities	$31,336	$33,065	$32,261	$32,863

* 113,337 shares on December 31, 1930; 153,937 shares on June 30, 1931.

† Due $100,000 annually on August 10. Callable in whole or in part on any interest date on 60 days' notice at 105 and interest.

‡ Due June 1, 1942. Callable in whole or in part on any interest date on 60 days' notice at 110 and interest prior to June 1, 1927, and thereafter at ½ of 1% less each year until 1937, and thereafter at 1% less each year until maturity.

§ Par $100. Dividend rate, 7% cumulative. Callable on any dividend date on 30 days' notice at 107.

‖ 820,513 shares of no-par value.

Exhibit 2
Henshaw Linoleum Company
Income Statement and Surplus Account
(In thousands of dollars)

Item	Jan. to Dec. 1928 (12 mos.)	Jan. to June 1929 (6 mos.)	Jan. to Dec. 1929 (12 mos.)	Jan. to June 1930 (6 mos.)	Jan. to Dec. 1930 (12 mos.)	Jan. to June 1931 (6 mos.)
Income Statement						
Operating profit	$ 1,988	$ 1,211	$ 2,639	$ 978	$ 639	$ 776
Interest, dividends, royalties, etc.	527	280	675	187	459	200
Total income	$ 2,515	$ 1,491	$ 3,314	$ 1,165	$ 1,098	$ 976
Deductions:						
Depreciation	906	470	951	404	790	319
Interest	104	49	99	48	93	38
Federal taxes (estimated)	189	117	272	78	27	72
Total deductions	$ 1,199	$ 636	$ 1,322	$ 530	$ 910	$ 429
Net income	1,316	855	1,992	635	188	547
Less: Preferred dividends	95	48	94	45	88	42
Earned on common	$ 1,221	$ 807	$ 1,898	$ 590	$ 100	$ 505
Less common dividends						
Balance to surplus	$ 1,221	$ 807	$ 1,898	$ 590	$ 100	$ 505
Surplus Account						
Earned surplus at beginning of period	$11,846	....	$13,022	....	$14,875	$14,930
Balance after dividends, as above	1,221	....	1,898	....	100	505
	$13,067	....	$14,920	....	$14,975	$15,435
Less: Appropriated surplus for sinking fund 7's of 1942	45	....	45	....	45	
Earned surplus at end of period	$13,022	....	$14,875	....	$14,930	$15,435
Capital surplus, created by valuation of goodwill, trademarks, and patents	900	....	900	....	900	900
Appropriated surplus for sinking fund 7's of 1942	246	....	291	....	336	336
Combined surplus, end of period	$14,168	....	$16,066	....	$16,166	$16,671

EXHIBIT 3

MANUFACTURE OF HARD-FINISHED FLOOR COVERINGS IN THE UNITED STATES

LINOLEUM

Year	Number of establishments	Wage earners	Square yards (000 omitted)	Value (000 omitted)	Wages, percentage of value	Materials (including power), percentage of value
1919	..	.....	31,932	$27,457		
1921	9	4,877	38,301	32,629	16	57
1923	7	6,261	53,060	44,589	16	52
1925	6	4,872	52,830	44,513	14	45
1927	7	5,364	49,921	42,039	17	51
1929	7	5,544	48,272	48,744	15	48
1931	6	2,895	20,372	19,408	16	34
ASPHALT FELT-BASE FLOOR COVERINGS						
1919	..	.....	30,369	$13,909		
1921	10	816	31,728	13,042	10	37
1923	9	1,682	71,076	30,240	9	36
1925	11	2,464	77,889	30,029	10	46
1927	12	2,442	111,793	34,900	11	47
1929	14	2,345	117,970	36,943	11	45
1931	15	1,927	87,477	21,460	14	47

Source: U. S. Census of Manufactures.

EXHIBIT 4

LINSEED-OIL PRICES*

(In cents per pound, raw, car lots, barrels, at New York)

Date	Average	Range
1925	13.94	12.50 to 15.47
1926	11.14	10.55 to 11.80
1927	10.47	9.50 to 11.35
1928	10.01	9.80 to 10.35
1929	12.27	10.03 to 15.90
1930	12.51	9.15 to 14.25
1931:		
January	8.80	
February	9.20	
March	9.45	
April	9.15	
May	8.80	
June	8 58	

* Range gives highest and lowest month of the year, but the monthly prices are themselves averages so that the true range would be somewhat wider than shown.

Source: *Standard Statistical Bulletin.*

EXHIBIT 5
HENSHAW LINOLEUM COMPANY
PRICE RANGE OF COMMON STOCK

Date	Low	High	Date	Low	High
1926	27⅞	52⅞	1931:		
1927	31	53½	January	12⅜	16¼
1928	39⅝	56¾	February	14⅝	20½
1929	19¾	64⅜	March	17⅛	23
1930:			April	14⅞	21⅛
January	24⅜	31¾	May	14⅞	18⅞
February	28¾	33¾	June	15	22½
March	29½	35½			
April	29⅞	33¾			
May	23⅝	30⅝			
June	18¼	26¾			
July	20¼	25			
August	18⅞	23⅞			
September	18	22¾			
October	14	19⅜			
November	14	16⅝			
December	10⅛	15¼			

6. FAIRFIELD MANUFACTURING COMPANY (I)

PURCHASE BY COMPANY OF ITS OWN PREFERRED STOCK

In February, 1933, the directors of the Fairfield Manufacturing Company were considering whether the company should apply cash which was in excess of immediate needs to the purchase and retirement of outstanding preferred stock. At that time the company had outstanding 17,700 shares of $4 cumulative convertible preferred stock, par value $60 per share, on which two years' dividends were in arrears. The plan proposed by some of the directors was that an offer should be made to holders of the stock to purchase one-third of their holdings at $18 plus one share of common stock for each share of preferred. Proponents of the plan recognized that, before making a final decision, careful estimates of working capital requirements would be necessary because of the possibility of a rise in the price of raw materials.

For over sixty years the Fairfield Manufacturing Company and its predecessors had been engaged in the manufacture of quilts. Whereas in its earlier years much of the product was of cheap quality, in recent years with the improved standard of living the demand for this type of goods diminished greatly, and the company turned to the manufacture of high-quality quilts. Through its recognition of the growing importance of the style factor in its products, the company had become the largest manufacturer of high-grade quilts in the country. The company had a plant for finishing cotton goods and to a limited extent engaged in several other phases of the textile industry.

Formerly the company had sold exclusively to wholesalers, who usually required an October delivery since sales to retailers were made largely during the fall months. Under these conditions the company found it desirable to depend upon bank loans for seasonal financing. In view of the fact that these loans could readily be liquidated in full after the selling season was over, the company experienced no difficulty in securing satisfactory lines of credit from its banks.

With the increasing importance of the style element, the company's sales began to be made directly to department stores, for the most part in the months of October, November, and December. These sales were made on a basis of 2% discount for cash within 10 days from the end of the month, a discount which

was taken by most customers. In the case of highly styled goods, moreover, the company tended to produce largely on order rather than for stock.

As a result of the changes in distribution and production, together with a decreased volume of business and lower commodity prices, inventories were reduced from $1,120,321 to $390,691 in 1931. Approximately $300,000 of the cash made available by the reduction in working capital requirements was used early in 1932 to purchase 16,300 shares of preferred stock at $18 plus one share of common stock per share.

The company's preferred stock had been issued in December, 1928, and was held by about 600 persons. Originally, it had been planned to have this stock listed on the New York Curb Exchange. Since the 1929 stock market break had made this inexpedient, there was no established market for the shares. Dividends had been paid on the issue in 1929 and 1930, but continued losses in 1931 made it impossible to maintain dividend disbursements. After a year's lapse in dividend payments the sole voting power had passed to the preferred stockholders.

In 1932 sales of the Fairfield Manufacturing Company declined, and the price of cotton remained at a low level (see Exhibit 3). Consequently the company did not find it necessary to borrow and ended the year with inventories further reduced and with more cash than it had at the beginning of the year despite the purchase of preferred stock. In view of this situation, some of the directors, who were also holders of large blocks of preferred stock, proposed again using cash, in the amount of $106,000, for the purchase of preferred stock.

In support of their proposition, they attempted to show that it would be advantageous to all stockholders for the following reasons:

1. Surplus would be materially increased.
2. The value of the remaining preferred shares and of the common shares would be somewhat increased.
3. Preferred dividend requirements would be substantially reduced.
4. A market for preferred stock would be created for those desiring to sell.

Before the directors' meeting the treasurer of the company had consulted bankers in regard to the proposed plan and its possible effect on the company's credit standing. He presented to the bankers approximate estimates of working capital requirements

EXHIBIT 1
FAIRFIELD MANUFACTURING COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932
ASSETS				
Cash	$ 320,230	$ 315,543	$ 433,345	$ 458,562
Marketable Securities	98,681	....	496,872	229,894
Accrued Interest Receivable	....	....	4,080	2,271
Accounts Receivable, Less Reserves	422,151	304,914	185,308	126,713
Merchandise Inventories	1,481,252	1,120,321	390,691	289,407
Total Current Assets	$2,322,314	$1,740,778	$1,510,296	$1,106,847
Investments and Miscellaneous Assets	52,312	42,280	47,027	57,264
Land, Buildings, and Machinery, Less Depreciation	1,069,343	1,040,576	943,028	869,535
Deferred Charges	13,736	14,591	10,414	8,385
Total Assets	$3,457,705	$2,838,225	$2,510,765	$2,042,031
LIABILITIES				
Accounts Payable	$ 69,953	$ 35,197	$ 11,085	$ 13,697
Accrued Accounts	16,538	13,195	25,779	23,927
Reserve for Income Taxes	34,063			
Total Current Liabilities	$ 120,554	$ 48,392	$ 36,864	$ 37,624
$4 Cumulative Convertible Preferred Stock	2,100,000	2,040,000	2,040,000	1,062,000
Common Stock	400,000	400,000	400,000	420,000
Capital Surplus	....	....	....	665,986
Operating Surplus	837,151	349,833	33,901	143,579[d]
Total Liabilities	$3,457,705	$2,838,225	$2,510,765	$2,042,031*
STOCK STRUCTURE				
$4 Cumulative Convertible Preferred Stock, Par, $60; Convertible to 2 Shares Common:				
Authorized	35,000 sh.	35,000 sh.	35,000 sh.	35,000 sh.
Outstanding	35,000 sh.	35,000 sh.	35,000 sh.	29,000 sh.
Less, in Treasury	....	1,000 sh.	1,000 sh.	11,300 sh.
Net Outstanding	35,000 sh.	34,000 sh.	34,000 sh.	17,700 sh.
Common Stock, No-par Value:				
Authorized	120,000 sh.	120,000 sh.	120,000 sh.	150,000 sh.
Outstanding	110,000 sh.	110,000 sh.	110,000 sh.	132,000 sh.
Less, in Treasury	....	. ...	....	6,000 sh.
Net Outstanding	110,000 sh.	110,000 sh.	110,000 sh.	126,000 sh.

* Preferred dividends in arrears for two years amounted to $141,600.
[d] Deficit.

EXHIBIT 2

FAIRFIELD MANUFACTURING COMPANY

INCOME AND SURPLUS ACCOUNT, YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932
INCOME ACCOUNT				
Gross profit from operations	$506,856	$ 57,408	$ 12,189	$ 73,957
Other income	37,854	....	....	10,295
Total	$544,710	$ 57,408	$ 12,189	$84,252
Deduct:				
General administrative and selling expenses	260,200	322,141	225,497	195,275
Depreciation	*	78,842	79,603	66,457
Federal income taxes	30,153			
Miscellaneous charges	30,614	14,262	5,796	
Total	$320,967	$415,245	$310,896	$261,732
Net profit	223,743	357,837[d]	298,707[d]	177,480[d]
SURPLUS ACCOUNT				
Capital surplus, arising from discount on preferred stock purchased	....	....	....	$665,986
OPERATING SURPLUS				
Balance, January 1	$744,816	$837,151	$349,833	$ 33,901
Net profit for year	223,743	357,837[d]	298,707[d]	177,480[d]
Discount on purchase of preferred stock	....	12,306		
Tax adjustments	....	789	12	
Miscellaneous adjustments	8,592	....	8,612	
Total	$977,151	$492,409	$ 59,750	$143,579[d]
Deduct:				
Tax adjustments	....	....	25,849	
Miscellaneous adjustments	....	6,021		
Preferred dividends paid	140,000	136,555		
Total	$140,000	$142,576	$ 25,849	
Balance, December 31	837,151	349,833	33,901	$143,579[d]
Index of sales	100%	70%	50%	31%

* Deducted before stating gross profit.

[d] Deficit.

EXHIBIT 3
COTTON PRICES
NEW YORK—SPOT MIDDLING UPLANDS
(Unit: Average of one price weekly in cents per pound)

Month	1929	1930	1931	1932	1933
January	20.23	17.22	10.28	6.45	6.10
February	20.22	15.62	10.96	6 44	
March	21.19	15.18	10.91	6.66	
April	20.33	16.42	10.19	6.15	
May	19.53	16.43	9.38	5 63	
June	18.72	14.47	9.05	5.19	
July	18.62	13.11	9.29	5 66	
August	18.64	12.03	7.22	7.25	
September	18.85	10.96	6.50	7.62	
October	18.46	10.62	6.32	6 59	
November	17.53	10.94	6.44	6.14	
December	17.27	10.01	6 24	5 82	
Average	19.13	13.58	8.57	6.30	

Source: *Standard Statistical Bulletin.*

V

REFUNDING AND REFINANCING

1. BLANCHARD CORPORATION[1]

SALE OF MORTGAGE BOND ISSUE IN TWO SERIES

The Blanchard Corporation owned all the common stock of the Blanchard Stores Company, an exclusive women's specialty store, and all the stock of the Blanchard Catering Company, in addition to three buildings located in the Chicago business district. The two outstanding series of bonds bore 6% and 7% interest, respectively, and the preferred stock, dividends of 8%. In the spring of 1928, after a reappraisal of properties, the management was contemplating the sale of $7,875,000 of 5% bonds to simplify the financial structure and to reduce interest and dividend charges by taking advantage of the demand for real estate securities.

EXHIBIT 1

BUILDINGS OWNED BY BLANCHARD CORPORATION, MARCH, 1928

Building	Height (stories)	Built	Net rental area (sq. ft.)	Land area (sq. ft.)	Ownership of land	Amount of lease
Blanchard........	13	1914	247,174	12,649	Lease	$56,000
Hudson..........	10	1893	64,044	6,300	Fee	
Nighber.........	9	1891	35,305	3,896	Fee	

The three buildings owned by the Blanchard Corporation (see Exhibit 1) were situated in the heart of the retail district of Chicago near the city's leading department stores and only one block from Michigan Avenue, the most important north and south boulevard of the city. The Blanchard Stores Company occupied the first seven floors and the double basement of the Blanchard Building, the largest and most modern of the three structures.

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

The remaining floors, known as the Blanchard Building Shops, contained retail jewelry, engraving, antique, and women's specialty shops. The land occupied by this building was held under leases expiring in 1992, 2000, and 2010, respectively, and requiring an annual rent payment of $56,000 until expiration. The Blanchard Corporation rented the Hudson and Nighber Buildings for stores, shops, and offices.

EXHIBIT 2
BLANCHARD CORPORATION
INCOME STATEMENT, YEARS ENDED DECEMBER 31

Item	1926	1927
Rentals	$1,183,911	$1,190,260
Operating expenses:		
Ground rent	59,375	59,375
Taxes	195,641	189,140
Insurance	6,527	7,360
Maintenance charges	31,855	13,455
Wages and expenses (net)	190,923	183,832
General expenses	51,495	49,415
Net operating income	$ 648,095	$ 687,683
Depreciation	73,102	74,271
Amortization of leaseholds	26,885	26,891
Net income	$ 548,108	$ 586,521
Dividends and interest received (net)	116,049	73,539
Net available for interest	$ 664,157	$ 660,060
Bond interest	322,890	323,943
Amortization of bond discounts and expenses	19,935	19,492
Federal income taxes	32,555	35,147
Balance for adjustments and dividends	$ 288,777	$ 281,478
Net surplus adjustments	159,781*	20,732[d]
Balance for dividends	$ 448,558	$ 260,746
Preferred dividends	140,000	140,000
Common dividends	122,500	87,500
Surplus for year	$ 186,058	$ 33,246

* Includes a $175,000 stock dividend declared by Blanchard Stores Company.
[d] Deficit.

Income statements of the Blanchard Corporation for the years ending December 31, 1926 and 1927, are given in Exhibit 2, and the gross and net income from the mortgaged properties from 1923 to 1927 in Exhibit 3. The land leases and buildings were valued at $10,673,773 on the basis of a 1923 appraisal plus sub-

sequent additions at cost until an appraisal in January, 1928, indicated the value at $14,062,342 (see Exhibit 4).

EXHIBIT 3
BLANCHARD CORPORATION
EARNINGS, 1923–1927

Year ending	Gross income	Net income before depreciation and Federal taxes
September 30, 1923	$1,018,093	$544,629
December 31, 1924	1,106,555	621,931
December 31, 1925	1,136,335	650,532
December 31, 1926	1,183,911	648,095
December 31, 1927 (actual)	1,190,260	687,683
December 31, 1927 (adjustment made for 1928 leases)	1,294,731	792,154

EXHIBIT 4
BLANCHARD CORPORATION
APPRAISAL OF LAND, LEASES, AND BUILDINGS IN JANUARY, 1928

Value of land:		
Fee 12,650 sq. ft.	......	$ 6,642,160
Leaseholds:		
2,530 sq. ft. (16.8 by 150.6 ft.) at $21,000 a year (lease expiring 2010)	$ 718,410	
5,060 sq. ft. (33.6 by 150.6 ft.) at $24,500 a year (lease expiring 1992)	1,871,135	
5,060 sq. ft. (33.6 by 150.6 ft.) at $10,500 a year (lease expiring 2000)	1,105,300	3,694,845
Value of buildings:		
Blanchard Building	$3,253,782	
Hudson Building	280,000	
Nighber Building	175,000	
Building on alley between Hudson and Nighber Buildings	16,555	3,725,337
Total value	......	$14,062,342

A plan seriously considered provided for the sale of $7,875,000 of 5% first mortgage bonds to retire the outstanding $4,720,100 of 6% mortgage bonds, the $520,100 of 7% serial bonds, and the $1,750,000 of 8% preferred stock. Interest and dividend charges of $459,613 under the existing capitalization would be reduced to $393,750 under the new plan. The balance sheet before and after the reappraisal and proposed financing is given in Exhibit 5.

The original proposal was that the $7,875,000 bond issue be divided into $7,000,000 of Series A and $875,000 of Series B. The series were to be identical except that the B bonds would be subordinate in lien to the A series. The B issue was to be convertible by lot into A bonds, if at the end of the conversion the outstanding A securities would not exceed 50% of the value of the property at that time; the property was to be valued peri-

EXHIBIT 5
BLANCHARD CORPORATION
BALANCE SHEET, AS OF DECEMBER 31, 1927

Item	Actual	After the reappraisal and if proposed financing were effected
ASSETS		
Land Owned in Fee	$ 4,387,014*	$ 6,642,160
Leaseholds (Net)	2,021,788*	3,560,445
Building in Alley	106,867†	134,400
Buildings, Less Depreciation	4,158,104*	3,725,337
Furniture and Fixtures, Less Depreciation	4,027	4,027
Bond Interest and Retirement Fund with Trustee	35,085	
Cash	6,245	33,018
Notes and Accounts Receivable, Less Reserves	35,217	35,217
Investments in 100% Owned Subsidiaries:		
Blanchard Stores Company Stock (Book Value)	1,422,629	1,422,629
Blanchard Catering Company Stock (at Cost)	25,648	25,648
Bond Discount	191,730	891,556
Prepaid Insurance and Ground Rental	13,548	13,548
Total Assets	$12,407,902	$16,487,985
LIABILITIES		
First Mortgage Bonds	$ 4,720,100‡	$ 7,000,000§
Bonds	520,100‖	875,000¶
Accounts Payable	19,224	19,224
Local Taxes	191,172	191,172
Federal Income Taxes, 1927	35,287	31,968
Bond Interest	26,634	
Prepaid Rental Income	9,409	9,409
Preferred Stock 8% Cumulative $100 Par	1,750,000	
Common Stock $100 Par	1,400,000	1,400,000
Surplus from Property Appraisals	3,539,349	6,927,919
Earned Surplus	196,627	33,293
Total Liabilities	$12,407,902	$16,487,985

* Appraised in 1923.
† At cost.
‡ 6 %.
§ 5 % Series A.
‖ Serial 7 %.
¶ 5 % Series B.

odically under the terms of the mortgage indenture. The mortgage would provide for the issuance of additional Series A bonds for not more than 60% of the actual cost of acquiring unencumbered fee simple title to lands then held under ground leases and of new improvements to the present sites. It also would provide for the release, under the restrictions of the mortgage, of any of the property from under its lien, provided, however, that the aggregate Series A bonds to be outstanding should not exceed 50% of the then value of the property remaining or to be subjected to the lien of the mortgage after such action, and, also in the case of releases, that the value of the fee property remaining subject to the lien of the mortgage would be at least 110% of the principal amount of the Series A bonds outstanding.

The investment firm which was working with the Blanchard Corporation on the proposed financing believed that the A bonds could be sold to the public at 98 to yield 5.16% and the B series at 95 to yield 5.4%. Another suggestion was identical except that the entire $7,875,000 issue should be sold in one series.

Should the bonds have been sold in two series or one? If the latter, at what price could the entire issue have been marketed?

2. EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON

DETROIT EDISON COMPANY

REFUNDING AND DEBT RETIREMENT POLICIES

Before 1932 the public utility business had gradually come to be recognized as an industry justified in maintaining a perpetual fixed debt. As bond issues became due, it was the practice of most companies to bring out new issues of sufficient amounts to retire the maturing debt and to provide additional capital for current needs. Security market conditions determined for the most part the duration and the price of refunding issues. Since inability to refund on some terms was never contemplated by a company with a stable record of earnings, provision for a sinking fund usually was not included in utility bond issues.

In view of conditions in the capital markets in 1932 and 1933, some utility companies were unable to refund maturing debts and in consequence were forced into receivership and reorganization. These instances of reorganization instigated criticism of the financial policies of utilities with respect to their failure to provide for the retirement of funded debt from earnings. Notwithstanding that provision for sinking funds had not been made by the Edison Electric Illuminating Company of Boston and the Detroit Edison Company, two companies which had to meet the problem of debt retirement in 1931–1934, these utilities were able to take care of their maturities through customary channels.

From its organization in 1886 the Edison Electric Illuminating Company of Boston had expanded by acquiring other utilities until in 1934 it served a population of about 1,360,000. Operating under a perpetual charter from the Commonwealth of Massachusetts, the company was within the jurisdiction of the state Department of Public Utilities. The regulation by the latter included supervision of rates, accounting, the issue of capital stock and bonds, and the issue of coupon notes maturing over three years from date of issue. This department, in August, 1929, denied the company permission to reduce the par value of its stock from $100 to $25 per share.

The methods by which the company financed its operations and the expansion of assets of about $100,000,000 in the period from 1920 to 1934 are indicated in the accompanying exhibits.

In the years 1929–1934 the Edison company from time to time planned to refinance maturities of its short-term notes by an issue of stock. An offering of stock at a fair price was precluded, however, by the condition of the security markets during this period. For example, in October, 1929, the company had asked authority of the Department of Public Utilities to issue 76,411 shares of stock, but the subsequent decline of the stock market caused the company to withdraw this petition.

On July 2, 1934, 20 days after filing a registration statement in accordance with the Securities Act,[1] the Edison Electric Illuminating Company of Boston sold to an underwriting syndicate headed by The First Boston Corporation $35,000,000, 3% coupon notes due July 16, 1937. At 98.24% of par, the price paid by the underwriters, the Edison company realized $34,384,000. Of this amount, $25,000,000 was used to retire coupon notes that became due on July 16, and $7,000,000 to pay off bank loans. The remainder reimbursed the treasury for funds used to liquidate bank loans in April.

The Detroit Edison Company, organized in 1903 as a consolidation of two electric companies serving Detroit, subsequently acquired control of several utilities operating in surrounding territory. In 1934 it served a compact, highly industrialized territory including over 4,500 sq. miles and with a total population of more than two million. Whereas franchises held by the company in the city of Detroit were perpetual, those held outside were chiefly of the 30-year type.

In financing an expansion of assets of nearly $200,000,000 in the period from 1920 to 1934, the Detroit Edison Company, in contrast to the Edison Electric Illuminating Company of Boston, avoided the use of short-term notes and confined its funded debt to long-term mortgage bonds and 10-year convertible debentures. In the later years this company followed a policy of simplifying its capital structure (see exhibits). As a final step in the program,

[1] The Securities Act of 1933, as signed by the President on May 27 of that year, required the filing of a registration statement before the issuance of a new security and specified the information to be contained therein as well as the data to be presented in the prospectus. The Act provided stringent civil and criminal liabilities for violations, which included misstatements and omission of material facts in the registration statement A rider to the Securities Exchange Act, approved by the President on June 6, 1934, relaxed somewhat the restrictions in the original law. For discussions of the original act, giving both sides of the argument, see Bernard Flexner, "The Fight on the Securities Act," *Atlantic Monthly*, Vol. 153, No. 2, pp. 232–252, February, 1934; and Eustace Seligman, "Amend the Securities Act," *Atlantic Monthly*, Vol. 153, No. 3, pp. 370–380, March, 1934.

the Detroit Edison Company in 1932 retired its remaining underlying bonds with the proceeds of an issue of general and refunding 20-year 5% mortgage bonds. The company's funded debt then consisted solely of bonds issued under its general and refunding mortgage, which contained no sinking fund provision. The earliest maturity date of the bonds issued under this mortgage was for the Series A due in 1949.

1. Show in detail the sources of funds obtained by the two companies for financing expansion.

2. Describe and discuss the refunding policies with particular reference to the 1930–1933 period.

3. Can the methods used for borrowing and repaying funds be explained by differences in conditions under which the companies operated? If not, then which of the two companies followed the more sound financial policy in the period for 1930–1933? What are the tests and proofs of sound financial policy with respect to the procurement and administration of funds by a public utility company?

4. Defend or attack the proposition that public utility managements should provide out of income for the retirement of all funded debt contracted.

EXHIBIT 1

EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON

IMPORTANT BALANCE SHEET ITEMS, AS OF DECEMBER 31

(In thousands of dollars)

Year	Property and plants (net)	Cash	Total current assets	Other assets	Total assets	Current liabilities	Surplus
1920*	$ 59,139	$ 674	$ 3,648	$2,196	$ 64,983	$1,981	$ 401
1921*	63,583	1,270	4,343	896	68,822	1,679	495
1922	69,779	973	3,747	476	74,002	1,651	603
1923	79,790	2,558	6,333	265	86,388	1,972	599
1924	99,332	1,073	5,381	......	104,713	2,025	766
1925	109,892	429	4,669	320	114,881	2,599	647
1926	116,196	387	5,035	1,471	122,702	2,524	514
1927	126,367	30,314	34,790	1,030	162,187	2,910	841
1928	132,516	1,097	5,392	45	137,953	2,138	1,022
1929	141,975	805	5,968	......	147,943	2,911	1,233
1930	151,977	887	5,626	643	158,246	3,240	1,282
1931	157,087	3,131	7,952	250	165,289	3,273	1,286
1932	159,121	6,436	11,602	626	171,349	3,260	1,186
1933	157,991	2,124	7,636	1,357	166,984	2,460	1,253

* June 30.
Source: Company reports.

EXHIBIT 2

EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON

EARNINGS STATEMENT, YEARS ENDED DECEMBER 31

(In thousands of dollars)

Year	Gross revenues	Operating expenses, maintenance, and taxes	Depreciation	Available for fixed charges	Fixed charges	Dividends paid	Additions to surplus
1920*	$13,921	$ 8,822	......	....	$1,165	$2,703	
1921*	16,163	10,959	......	....	1,410	2,703	
1922	15,886	10,362	$ 800	$ 4,752	1,507	3,241	$ 17
1923	17,878	11,367	1,350	5,171	1,305	3,891	1
1924	19,495	11,833	1,800	5,936	1,173	4,668	28
1925	.21,315	13,122	1,300	7,004	1,599	5,606	145
1926	23,205	13,609	2,300	7,339	1,866	5,606	423
1927	25,887	14,854	3,200	7,948	1,900	6,006	130
1928	27,750	15,344	3,950	8,598	2,061	6,406	42
1929	29,665	16,644	3,300	9,794	2,531	6,840	133[d]
1930	30,617	17,429	2,650	10,847	3,427	7,274	201[d]
1931	30,815	17,577	2,750	10,587	3,285	7,274	95
1932	30,578	17,586	2,400	10,676	4,043	6,632	25[d]
1933	29,291	16,495	3,275	9,661	4,295	5,349	4

* Years ended June 30.
[d] Deficit.
Source: *Standard Corporation Records.*

EXHIBIT 3

EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON

CAPITALIZATION, AS OF DECEMBER 31

(In thousands of dollars)

Year	Capital stock	Premium on capital stock	Installments paid on capital stock	Coupon notes	Notes payable
1920*	$22,528	$17,919	......	$19,004†	$ 1,901
1921*	22,528	17,919	......	19,000†	5,951
1922	27,034	19,293	$ 787	16,000†	7,385
1923	32,440	22,001	4,306	12,000†	11,820
1924	38,928	24,615	620	12,000	25,760
1925	46,714	28,915	......	30,000	6,005
1926	46,714	28,915	......	30,000	14,035
1927	53,388	36,605	......	64,428	4,015
1928	53,388	36,605	......	30,000	14,800
1929	53,488	36,916	......	38,500	14,895
1930	53,488	36,916	......	60,000	3,320
1931	53,488	36,916	......	70,000	325
1932	53,488	36,916	......	75,000	411
1933	53,488	36,916	......	61,000	10,000‡

* June 30.
† Also outstanding $1,250,000 of first mortgage bonds.
‡ Paid April 16, 1934, by borrowing $7,000,000 from banks, and taking $3,000,000 from cash.
Source: Company reports.

EXHIBIT 4

EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON

TABULAR DESCRIPTION OF COUPON AND DISCOUNT NOTES

Date issued	Amount of issue (thousands of dollars)	Rate	Maturity date	Offering price
Jan. 16, 1922	$12,000	5½ %*	Jan. 15, 1925	99.15
Jan. 16, 1922	4,000	5½ %*	Jan. 15, 1923	100.00
Apr. 30, 1924	8,000	4.80%†	Jan. 15, 1925	
Jan. 15, 1925	30,000	4½ %*	Jan. 15, 1928	99.31
Jan. 29, 1927	2,000	4⅛ %†	July 29, 1927	
Mar. 30, 1927	2,200	4.15%†	Sept. 30, 1927	
Nov. 1, 1927	30,000	4½ %*	Nov. 1, 1930	100.00
Nov. 2, 1927	10,000	4%*	Nov. 2, 1928	99 75
Apr. 25, 1929	8,000	7%†	Oct. 25, 1929	
Apr. 30, 1929	8,500	6%†	Apr. 30, 1930	
Jan. 15, 1930	30,000	5%*	Jan. 15, 1933	98.75
Nov. 1, 1930	10,000	3¾ %*	Nov. 1, 1931	99 87
Nov. 1, 1930	20,000	4%*	Nov. 1, 1932	99 62
Oct 1, 1931	20,000	4½ %*	Oct. 1, 1932	100.00
May 2, 1932	10,000	4½ %*	May 2, 1933	99.76
May 2, 1932	20,000	5%*	May 2, 1935	98.79
Apr. 15, 1933	10,000	3½ %†	Oct. 16, 1933	
July 16, 1932	25,000	5%*	July 16, 1934	99.62
Apr. 15, 1933	16,000	5%*	Apr. 15, 1936	99.00
Apr. 15, 1933	10,000	3½ %†	Oct. 16, 1933	
July 16, 1934	35,000	3%*	July 16, 1937	100.00

* Coupon rate.
† Discount rate.
Source: Moody's *Public Utilities*.

EXHIBIT 5
EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON
ANNUAL PRICE RANGE—COMMON STOCK

Year	High	Low
1920	164	140
1921	166¼	142¼
1922	185	156
1923	172	152⅝
1924	204½	163½
1925	213	200
1926	250	207
1927	267	217
1928	305	252
1929	440	201
1930	276	225
1931	266½	164
1932	205	219
1933	183	118

Source: *Standard Corporation Records.*

EXHIBIT 6
EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON
SHARES OFFERED TO STOCKHOLDERS SINCE 1920

Year	Shares offered	Ratio of offering (per cent)	Subscription price	Shares subscribed by stockholders
1921	45,056	20	$130	44,622
1922	54,067	20	150	53,696
1923	64,881	20	140	64,281
1924	77,857	20	155	77,457
1927	66,734	14¾	215	66,407
Total...........	308,595	....	....	306,463

Source: *Standard Corporation Records.*

EXHIBIT 7
EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON
SUMMARY OF ALL STOCK ISSUED JUNE 30, 1920 TO DECEMBER 31, 1933

Shares outstanding, June 30, 1920.........................	225,280
Shares sold to stockholders, as shown in Exhibit 6...........	306,463
Shares sold to the public................................	2,132
Shares sold at public auction to capitalize additions to steam-producing properties..................................	1,000
Shares outstanding, December 31, 1933....................	534,875

Source: *Standard Corporation Records.*

EXHIBIT 8
EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON
DIVIDENDS PAID ON COMMON STOCK IN CALENDAR YEARS

Year	Percentage
1920–1928 (each year)	12.0
1929	12.4
1930–1931 (each year)	13.6
1932	12.8
1933	10.5

Source: *Standard Corporation Records.*

EXHIBIT 9
DETROIT EDISON COMPANY
IMPORTANT BALANCE SHEET ITEMS, AS OF DECEMBER 31
(In thousands of dollars)

Year	Property and plants (net)	Cash	Total current assets	Other assets	Total assets	Capital stock	Funded debt	Current liabilities	Surplus
1920	$ 76,310	$ 890	$10,219	$ 7,044	$ 93,573	$ 27,663	$ 50,808	$13,448	$ 1,654
1921	82,555	802	9,876	8,695	101,126	28,013	64,299	6,848	1,966
1922	90,849	2,469	11,110	9,872	111,831	34,938	69,206	5,071	2,617
1923	103,070	1,648	12,614	10,851	126,535	45,597	68,810	7,642	4,099
1924	126,431	3,691	14,386	11,639	152,456	62,458	75,364	7,833	5,606
1925	142,028	1,572	16,114	10,853	168,995	79,955	72,378	7,616	7,543
1926	168,931	1,506	17,646	11,536	198,113	89,127	86,337	11,177	9,428
1927	188,939	1,590	17,505	11,267	217,711	89,661	105,802	8,094	11,897
1928	209,114	1,860	17,632	11,917	238,663	105,463	105,129	9,638	15,708
1929	235,256	2,445	24,359	12,766	272,381	127,024	104,732	16,934	20,487
1930	247,518	3,635	18,720	13,232	279,470	127,060	118,134	9,256	21,691
1931	251,644	2,737	18,292	17,984	287,920	127,226	129,000	8,667	19,608
1932	260,436	4,975	20,778	9,064	290,278	127,226	134,000	8,181	18,239
1933	260,490	4,977	18,219	10,410	289,119	127,226	134,000	6,781	18,900

Source: Company reports.

EXHIBIT 10
DETROIT EDISON COMPANY
EARNINGS STATEMENT, YEARS ENDED DECEMBER 31
(In thousands of dollars)

Year	Gross revenues	Operating expenses, maintenance, and taxes	Depreciation	Available for fixed charges	Fixed charges	Dividends	Additions to surplus
1920	$21,990	$17,057	$ 400	$ 4,534	$2,463	$ 2,202	$ 131[d]
1921	23,383	15,639	1,460	6,284	3,434	2,234	616
1922	26,408	16,824	2,415	7,145	3,885	2,599	1,014
1923	31,724	19,345	3,020	9,335	4,187	3,062	2,086
1924	34,163	20,898	3,500	10,241	4,139	3,968	2,133
1925	38,949	21,824	4,515	12,585	4,195	5,472	2,918
1926	44,855	25,361	5,500	13,968	4,170	6,354	3,444
1927	47,380	26,206	5,950	15,195	5,044	6,973	3,179
1928	52,366	27,552	6,550	18,232	5,588	7,198	5,445
1929	56,558	30,180	7,400	18,944	5,798	8,331	4,815
1930	53,707	29,666	6,900	17,102	5,986	9,897	1,220
1931	49,233	27,811	4,000	17,383	5,953	10,151	1,278
1932	44,070	25,643	5,500	12,868	6,236	8,851	2,219[d]
1933	41,492	24,625	4,032	12,835	6,689	5,047	1,099

[d] Deficit.
Source: Company reports.

Exhibit 11
Detroit Edison Company
Ten-year Convertible* Debentures Outstanding, as of December 31
(In thousands of dollars)

Year	6%	7%	8%
1920	$ 150	$9,994	
1921	138	9,644	$5,533
1922	6,659	7,887	5,533
1923	6,945	7,419	5,462
1924	5,541	6,525	1,814
1925	1,025	1,869	
1926	600	1,252	
1927	458	860	
1928	272	373	
1929	157	90	
1930	134		
1931†			
1932†			
1933†			

* Into common stock at par.
† No debentures outstanding.
Source: Company reports.

Exhibit 12
Detroit Edison Company
Mortgage Bonds Outstanding, as of December 31
(In thousands of dollars)

Year	First Mortgage, 5s, 1933	E.M.E.* First Mortgage, 5s, 1931	First and Refunding 5s, 1940	First and Refunding 6s, 1940	General and Refunding A 5s, 1949	General and Refunding B 5s, 1955	General and Refunding C 5s, 1962	General and Refunding D 4½s, 1961	General and Refunding E 5s, 1952
1920	$10,000	$4,000	$16,665	$10,000					
1921	10,000	4,000	16,665	18,319					
1922	10,000	4,000	16,665	18,319					
1923	10,000	4,000	16,665	18,319					
1924	10,000	4,000	16,665	18,319	$12,500				
1925	10,000	4,000	16,665	18,319	12,500	$ 8,000			
1926	10,000	4,000	16,665	18,319	12,500	23,000			
1927	10,000	4,000	16,665	18,319	12,500	23,000	$20,000		
1928	10,000	4,000	16,665	18,319	12,500	23,000	20,000		
1929	10,000	4,000	16,665	18,319	12,500	23,000	20,000		
1930	10,000	4,000	16,665	18,319	26,016	23,000	20,000		
1931	10,000	......	....	....	26,000	23,000	20,000	$50,000	
1932	8,645†	......	....	....	26,000	23,000	20,000	50,000	$15,000
1933	....	......	....	....	26,000	23,000	20,000	50,000	15,000

* Eastern Michigan Edison.
† Technically outstanding, funds on deposit for redemption.
Source; Company reports.

EXHIBIT 13
DETROIT EDISON COMPANY
SUMMARY OF ALL STOCK ISSUED 1920–1933

Shares outstanding January 1, 1920	257,427
Shares sold to stockholders, as shown in Exhibit 14	660,652
Shares sold to public, including customers and employees	58,819
Shares taken by underwriters	50,286
Shares issued for the conversion of debentures	245,076
Shares outstanding December 31, 1933	1,272,260

Source: *Standard Corporation Records.*

EXHIBIT 14
DETROIT EDISON COMPANY
SHARES OFFERED AT PAR TO STOCKHOLDERS

Year	Shares offered	Per cent of holdings offered	Shares subscribed by stockholders
1920	55,326*	20	
1923	87,914	25	52,491
1924	111,513	25	96,650
1925	71,616	10	70,134
1926	80,928	10	79,788
1928	150,688	16⅔	150,137
1929	211,772	20	211,452
Totals	769,757		660,652

* Stockholders waived their rights to this issue in order that it might be sold to the general public.
Source: *Standard Corporation Records.*

EXHIBIT 15
DETROIT EDISON COMPANY
DIVIDENDS PAID ON COMMON STOCK

Year	Percentage
1920–1931 (all years)	8
1932	7.5
1933	4.5

Source: *Standard Corporation Records.*

Exhibit 16
Detroit Edison Company
Mortgage Bond Provisions

1. Detroit Edison Company, First 5s.
   Dated January 28, 1903; due January 1, 1933.
   Secured by a first mortgage on the entire property of the company including acquisitions, except Connors Creek plant and Huron River water powers.
   Not callable.
2. Eastern Michigan Edison, First 5s.
   Dated November 1, 1906; due November 1, 1931.
   Secured by a closed first mortgage on four hydroelectric plants on the Huron River.
   Guaranteed as to principal and interest and assumed by the Detroit Edison Company.
   Callable after November 1, 1916 at 110.
3. Detroit Edison Company, First and Refunding, 5s, Series A; 6s, Series B.
   Dated July 1, 1915; due July 1, 1940.
   Secured by a first mortgage on Connors Creek plant at Detroit and by a direct mortgage on practically all other property.
   Callable on any interest date on or before March 1, 1930 at 107½; thereafter to and including March 1, 1935 at 105; and thereafter at 102½.
4. Detroit Edison Company, General and Refunding 5s and 4½s, Series A to E.
   Dated (see Exhibit 12).
   Secured by a general mortgage on the entire property of the company and a deposit of $12,500,000 first and refunding bonds.
   Callable at schedules varying slightly from series to series; in general a declining scale beginning with 107 for the first 10 years.
   Additional bonds may be issued only (*a*) against deposit of an equal principal amount of First and Refunding Mortgage Bonds due July, 1940, (*b*) to retire an equal principal amount of underlying bonds, (*c*) against a cash deposit, equal to the principal amount of the bonds, or (*d*) for a principal amount not to exceed 75% of the actual cost, or fair value if less, of new property, provided that net earnings of the company for any period of 12 consecutive months in the 15 months preceding shall have been at least 1¾ times the annual interest charges on all bonds outstanding and to be issued.

Source: Moody's *Public Utilities.*

EXHIBIT 17
DETROIT EDISON COMPANY
ANNUAL PRICE RANGE—CAPITAL STOCK, $100 PAR VALUE

Year	High	Low
1920	108	91
1921	100	93½
1922	118½	100⅜
1923	111	100¼
1924	115¾	101¼
1925	159½	110
1926	141½	123½
1927	170½	133½
1928	224¼	116½
1929	385	151
1930	255¾	161
1931	195	110¼
1932	122	54
1933	91½	48

Source: *Standard Corporation Records.*

EXHIBIT 18
DETROIT EDISON COMPANY
ANNUAL RANGE—DEBENTURE AND BOND PRICES

Year	Convertible Debenture 6s		First Mortgage 5s		First and Refunding 5s		General and Refunding 5s, Series A	
	High	Low	High	Low	High	Low	High	Low
1921	. ...	.....	93¾	86¾	93½	76½		
1922	105	100	101½	94¼	100	89¼		
1923	101	100	100½	94¾	98	90¾		
1924	105¾	102⅝	101⅝	99	101	95	98	97
1925	146	Bid	102⅜	100	102¾	99½	101¾	97⅝
1926	137½	124½	102½	100¾	104⅜	101⅛	104⅜	100⅛
1927	143½	133⅛	103⅝	101⅜	104⅞	102⅛	105¾	102⅛
1928	175	Sale	103⅞	100¼	105¾	101¼	106¾	102¼
1929	275	Asked	103	97	104¾	97	104¼	99⅞
1930	...	....	103¾	100¼	.....	.....	106½	101¾
1931	.....	.....	104¾	100	.....	.....	108¼	96
1932	.....	....	102	100	.....	....	103½	95½

3. BUCKNELL TIN COMPANY[1]

PROPOSAL TO RETIRE BONDED DEBT

Several directors of the Bucknell Tin Company in February, 1928, wished to refund a 6% first mortgage bond issue of $4,200,000 which the company had sold in March, 1926. The retirement of these bonds, however, would be expensive, since they were callable at 103 but had been sold to investors at 97. Several directors who held large blocks of common stock either for themselves or for trust estates also were anxious to establish a market for the 68,560 shares of $100-par common stock. This stock had been closely held and only a few hundred shares had been bought and sold annually through brokers of unlisted securities. Until the sale of the bonds no income statements or balance sheets had been published. The price for the stock in 1924, 1925, 1926, and 1927 had had a narrow range from $100 to $120 a share.

In February, 1928, the directors were considering three tentative plans for refinancing the Bucknell Tin Company:

1. The bond issue might remain and the common stockholders receive three no-par-value shares for each $100-par share held.
2. The bond issue might remain and the stockholders receive one-half a share of preferred and one share of new no-par common stock for each share held.
3. The bond issue might be retired by the sale of 68,560 of the 205,680 shares of no-par common stock to be issued for the old stock.

The Bucknell Tin Company, following its establishment by three men in 1900, had been increasingly successful. On an original paid-in capital of $192,500 with subsequent total payments of $455,000 the stockholders had received $7,836,115 in cash dividends and $6,060,670 in stock. Although in 1927 earnings were at the rate of more than $12 a share and dividends for the past six years had been $8, investors were unable to sell their holdings on account of the narrow market for the shares. Since most of the 30 stockholders had a large part of their funds invested in the Bucknell Tin Company stock, they were unable to purchase additional offerings. One stockholder had left an estate in trust in 1922 containing a large block of the shares to be liquidated within the next five years at a fair price. The

[1] Reprinted from C E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

trustee, however, had been unable to obtain what he considered a fair return for the securities.

The Bucknell Tin Company manufactured and sold tin plate; its principal customers were tobacco, oil, and milk- and food-canning companies. The usual increase in the consumption of tin plate was about 10% a year. Moreover, the use of canned foods ordinarily did not decrease in times of general business depression. Earnings for the Bucknell Tin Company are included in Exhibit 1. In no year since 1905 had the company shown a deficit. Earnings for the past 10 years, excluding losses on Liberty bonds sold in 1919 and a fire loss in 1921, averaged $755,290. Increased earnings in 1926 and 1927 in the management's opinion had resulted entirely from the plant improvements financed by the bond issue, for, although net sales of $11,083,754 in 1925 were larger than those of $10,318,746 in 1926 and approximately the same as those for 1927, net profit in 1926 was 186% of that in 1925 and, in 1927, 225% of that in 1925. These improved earnings were despite steady declines in tin-plate prices from 1925 to 1927.

EXHIBIT 1
BUCKNELL TIN COMPANY
INCOME STATEMENT, YEARS ENDED DECEMBER 31

Item	1923	1924	1925	1926	1927
Net sales	$10,924,134	$10,287,105	$11,083,754	$10,318,746	$10,690,148
Other income	40,195	16,796	92,955	210,813	164,448
Gross income	$10,964,329	$10,303,901	$11,176,709	$10,529,559	$10,854,596
Expenses	10,284,756	9,587,714	10,344,309	9,143,789	9,279,471
Net income	$ 679,573	$ 716,187	$ 832,400	$ 1,385,770	$ 1,575,125
Depreciation	334,184	315,916	303,567	319,705	338,649
Bond interest and discount	42,245	39,573	40,737	230,725	268,388
Bank loan interest	533	3,870	40,270	16,871	
Federal taxes	39,096	49,256	61,674	118,651	123,169
Miscellaneous losses	....	3,696	10,900	....	774
Balance for dividends	$ 263,515	$ 303,876	$ 375,252	$ 699,818	$ 844,145

In December, 1927, as shown in Exhibit 2, the Bucknell Tin Company plant was valued at $6,790,364 after depreciation including the $1,400,000 of improvements made since 1926, although the value by a 1926 appraisal was $8,400,000. The management contemplated no further additions to plant, since the cost of erection would be large.

EXHIBIT 2
BUCKNELL TIN COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1926	1927
ASSETS		
Land, Plant, and Equipment, Less Depreciation	$ 6,745,982	$ 6,790,364
Cash	1,598,178	1,393,666
Accounts Receivable	898,264	516,214
Notes Receivable	1,516,869	538,958
Inventories	1,458,143	2,107,310
Investments	317,930	388,908
Bond Discount	154,341	137,953
Other Assets	297,632	22,341
Total Assets	$12,987,339	$11,895,714
LIABILITIES		
Accounts Payable	$ 194,510	$ 398,767
Pay Rolls	134,877	66,853
Accrued Interest	84,000	84,000
Reserves for Federal Taxes	118,651	123,169
Mortgage Bonds	4,200,000	4,200,000
Reserves for Federal Taxes of Prior Years	82,445	78,046
Accrued Dividends	137,119	
Capital Stock ($100-par Common Shares)	6,856,000	6,856,000
Surplus	1,153,432	51,433
Miscellaneous Reserves	26,305	37,446
Total Liabilities	$12,987,339	$11,895,714

The directors had sold bonds in 1926 to provide the large investment necessary for new machinery and equipment to lower the company's operating costs and enable it to maintain its competitive position in the tin-plate industry. In March, 1926, the directors had considered the sale of stock unwise because of the unsettled condition of the stock market. Besides the $1,400,000 for additions to the plant, $657,300 of the proceeds from the $4,200,000 bond issue was devoted to retiring the outstanding 5% bond issue which matured in 1930 and the rest reserved for working capital. The new bonds maturing in 20 years were sold to the public at 97 and were callable at 103 until March 1, 1931, with a ½ of 1% reduction for each 5-year period thereafter. The sinking fund payments were as follows:

March 1, 1929 to March 1, 1933	$140,000
March 1, 1934 to March 1, 1938	210,000
March 1, 1939 to March 1, 1943	280,000
March 1, 1944 to March 1, 1946	350,000

The first plan of refinancing considered by the directors was to leave the bonds outstanding and to increase the common stock capitalization 300% by changing it to no-par value and giving the old stockholders three new shares for each share owned. This plan by increasing the capitalization and reducing the value of the shares should facilitate the sale of stock. Advocates of this proposal argued that there was no necessity of retiring the bonds since the interest was adequately covered and there was no need for raising additional funds.

The second plan proposed that each common shareholder should receive one-half a share of 6½% preferred and one share of new no-par-value common stock. By this plan a shareholder would be entitled to a preferred dividend; he also might sell the preferred stock and retain his interest in the common.

An investment firm proposed a third plan under which 68,560 shares of the total capitalization of 205,680 no-par-value shares were to be sold the public at $60. By use of the proceeds of this sale and of surplus cash in the treasury the Bucknell Tin Company could retire the bond issue. This plan, a variation of the first plan, required that the common stockholders waive their rights to subscribe to the 68,560 shares to be publicly sold, since by law the stockholders were entitled to first claim to any new shares offered.

Advocates of the first and third plans wished to list the stock on the local exchange or the New York Curb and suggested a $3 and $4 dividend, respectively, on the new capitalization. If the second plan was accepted, a $6 disbursement was planned.

Should the directors of the Bucknell Tin Company have retired the bond issue? If so, which plan of refinancing should they have approved?

4. THE NEW YORK CENTRAL RAILROAD COMPANY

CRITICISM OF REFUNDING PROGRAM BY MEMBER OF THE INTERSTATE COMMERCE COMMISSION

In April, 1934, the stockholders of The New York Central Railroad Company approved the issuance of $59,111,100 of 10-year 6% convertible bonds to meet maturities of $52,500,000 on May 1, 1934, and for other capital purposes. In order to carry out this financing, the stockholders had to ratify both a change in the 7,000,000 authorized shares of $100 par into the same number of shares without par value and also the substitution of 4,992,597 new shares having a stated value of $499,259,700 for the same number of $100-par-value shares at the time outstanding.

According to the plan announced in February, 1934, the company offered, until the date of issuance, May 10, 1934, new bonds at par in the ratio of $1,200 principal amount for each 100 shares of stock held. Each bond was convertible into stock at $40 a share for three years and at $50 a share thereafter. A sinking fund was to be set up to retire these bonds, which were callable at 105 from November 11, 1934, to May 10, 1937; at 102 from May 11, 1937, to May 10, 1940; at 101 from May 11, 1940, to May 10, 1943; and at par thereafter, plus accrued interest. The new convertible bonds were to be secured by bonds (see Exhibit 3) pledged with a trustee; with the retirement of any convertible bonds, upon either conversion or redemption, provision was made for the release of the collateral.

After ratification of the refinancing plan by the stockholders, the company applied to the Interstate Commerce Commission for approval of this plan and for permission to obtain a loan of $19,911,100 from the R. F. C. for three years. This sum was to provide cash equal to the face amount of bonds for which stockholders might not subscribe. The company had already obtained subscription agreements on the part of its directors and certain other stockholders for $12,800,000 of the bonds and had secured underwriting of $27,200,000. Since subscriptions for the new issue were not due until May 10, 1934, the company also requested an immediate temporary loan of $19,911,100 for a term of approximately 15 days to be used for the payment, in part, of the bonds maturing May 1. Interim loans by banks and bankers had been

arranged to meet the remainder of the $52,500,000 maturities, which must be paid on that date.

Through an arrangement with banks the company met these maturities on May 1 without recourse to the R. F. C. 15-day loan which, together with the refinancing plan, had been approved by the Interstate Commerce Commission on April 26. Furthermore, since the company received subscriptions from stockholders for over 97% of the new convertible bonds, according to a tabulation of May 11, the three-year loan of $19,911,100 for refunding was not required.

In connection with the decision of the Interstate Commerce Commission authorizing the refunding plan, Mr. Porter, one of its members, although concurring, criticized the plan severely. He stated that he acquiesced to the plan "only because of the far reaching results which at this critical juncture might follow from our withholding approval." His objections, in part, were as follows:[1]

In all but five of at least 40 years preceding 1932 Central stock sold above par. . . . In 1932 its market value dropped to $8.75. The mean between the extreme prices of 1929 and 1932 was, therefore, $132.63. From the low of 1932 the price of the stock rose nearly 700% to $58.50 in July 1933. The present price is around $35.

The Central announced this plan of financing on February 21, 1934. At noon that day trading in the new 6% bonds was inaugurated on the unlisted market in New York City on a "when issued" basis at an initial quotation of $111 bid—$113 asked. During the pendency of the application before us these bonds have sold at a premium of as high as 22%. The "rights" accorded the present stockholders to subscribe to the new bonds, from which the Central is to receive no return, have sold as high as $2.75. A distribution to the present stockholders of the Central of what is equivalent to a dividend of approximately $2.50 per share is thus proposed to be made out of the proceeds of a speculative appeal to the public created with our approval. On the total of approximately 5,000,000 shares of stock now outstanding, this distribution at present prices will amount to $12,500,000 at a time when the Central is urgently in need of funds.

. . . Except for the present emergency in railroad financing, I believe that, instead of giving our unqualified approval of the plan now before us, we should, under the law which directs us to act in the public interest, prevent such a squandering of railroad credit.

In the first place, this program is designed to take care of less than half of the Central's 1934 financial requirements, to say nothing of some $36,000,000 of maturities, including equipments, in 1935, and

[1] *Commercial and Financial Chronicle*, Vol 138, pp. 3098–3100, May 5, 1934.

$25,000,000 of short-term loans, due in 1935 and 1936, heretofore made by Reconstruction Finance Corporation with our approval. In addition to the two issues of bonds due May 1, 1934, totaling $52,500,000, and approximately $9,000,000 of equipment obligations maturing throughout the current year, the Central has outstanding a total of $69,200,000 of floating debt carried on its books as loans and bills payable . . . Against this floating indebtedness the Central held cash at the end of 1933 amounting to $20,682,205. Probably the Central's current cash requirement is at least $15,000,000.

It seems to me that if, at this time, we are to permit the Central to market its future credit, for as long a period as 10 years, we should insist that it enlarge its program to cover this floating debt and thus provide for its total requirements in one operation. If provision were also made to take care of this large and unwieldy amount of floating indebtedness the Central's present credit position would be greatly improved immediately and that improvement, in my judgment, would result in a very substantial increase (say 20 points) in the present market price for the stock. With the stock selling at around 55 to 60 a call on additional shares for 10 years would be reasonably priced at around par. With the conversion price placed at $100 no valid argument would remain for issuing no par stock. . . . Is it too much to expect that a stock with the volatility displayed by the rise from $8.75 in July, 1932, to $58.50 in July, 1933, on the brief and temporary recovery in business experienced at that time, will soon pass the conversion price of 40, after the financing is concluded? History shows the natural and reasonable business capacity of this property will place its stock well above that figure. Its natural position is par or better. It is the existence of this condition and the anticipation of the rise appealing to the speculative instinct which has already elevated the price of these convertible bonds to a premium of 22%.

A price of only 52 for the Central's stock now outstanding is equivalent to the value per share of the stockholders' equity at 40 after the new stock is issued. A price of only 65 per share for the present stock is the equivalent of that equity at 50. Every point of appreciation in the market price for this stock above 52 in three years or 65 in the next seven years is equivalent to a gift of $1,500,000 to the purchasers of these bonds which appear as reasonably good investments without this sweetening. The gift of this sum to the stockholders, representing as it does the credit of the Central, carries no public interest.

Emphasis is placed upon the fact that the proposed new convertible bonds will, by their terms, be redeemable at the option of the issuer at prices ranging from 105 until 1937, to par from 1943 to maturity. For the year 1933 the Central reported a deficit in net income of $5,400,000 which would have been substantially larger had not the Central, during that year, effected further deferment of its charges for maintenance and depreciation. It is clear that this call provision will be ineffective for the immediate future which is recognized in the present market price of 118 for the bonds.

. . . . . .'

Reverting again to the Central's credit and bearing in mind the character and value of the security which will underlie the new issue of bonds, I am unable to bring my mind to an understanding of necessity for dressing up a prime 6% obligation of this carrier with a conversion privilege which is appraised in the market place at a premium of $220 per $1,000 before the bonds are issued. Such a leverage should be used only sparingly, if at all, and certainly should not be exhausted on piece-meal financing which results in substantial profits being diverted from the carrier to its stockholders. In a series of subscription offerings in financing of this type, the consummation of each successive step reduces the appeal to the stockholder through dilution of his equity, thereby lessening the cash return to the offerer and the general success of the plan. With a lessened appeal in the second installment of financing is it reasonable to suppose the stockholders will be agreeable to accepting a lower rated coupon on their bonds than that now proposed?

. . . If we acquiesce in the views of this applicant and its bankers that the pressure of the times is so onerous to its financing that the Central should be permitted to market its future credit at discounts of 40 and 50% for its stock, at what figures may we not be urged to approve equity financing in respect of other roads of much lower credit standing? Once we indulge in the fiction of no par stock for one of the premier railroads of the country can we gracefully refuse to approve similar issues for other carriers? This will be most embarrassing. One of the outstanding characteristics of railroad capital structures to-day is the almost universal adherence to the sound principle of definitive capital stock. Are we about to launch upon an administrative policy which will negative the efforts made in the last 50 years to correct the financial abuses of the pioneer days of railroading? Are we now to let down the bars to speculative orgies in rail securities which will make the excesses of the recent past look tame by comparison?

Financial information relating to the questions at issue is given in Exhibits 1–6, pages 201–204.

1. Present in outline form an appraisal of Mr. Porter's criticism of the 1934 refunding program of The New York Central Railroad Company.

2. On the basis of this appraisal and an analysis of the refunding program, either defend this program or draw up a new plan for meeting the company's requirements.

EXHIBIT I

THE NEW YORK CENTRAL RAILROAD COMPANY

CONDENSED GENERAL BALANCE SHEET, AS OF DECEMBER 31, 1933

ASSETS	
Investment in Road, Equipment, Improvements on Leased Railway Property, Securities, etc., as Carried on the Books	$1,711,362,355
Cash	20,750,505
Material and Supplies	30,902,263
Other Current Assets	23,062,332
Deferred Assets and Unadjusted Debits	39,715,338
	$1,825,792,793
LIABILITIES	
Capital Stock, Outstanding	$ 499,259,689
Premium on Capital Stock	4,880,241
Equipment Trust Obligations	58,868,735
Mortgage Bonds	568,901,000
Debenture Bonds	17,560,200
Reconstruction Finance Corporation Loans	25,078,737
Miscellaneous and Other Obligations	741,986
Bank and Other Demand Loans	64,400,000
Railroad Credit Corporation Loan	4,800,000
Other Current Liabilities	40,512,628
Depreciation and Other Reserves	184,671,424
Deferred Liabilities and Other Unadjusted Credits	121,324,837
Appropriated Surplus	8,811,677
Profit and Loss—Balance	225,981,639
	$1,825,792,793

This balance sheet does not include the assets or liabilities of lessor, affiliated, terminal, or other companies, or the liability of The New York Central Railroad Company as guarantor or under leases or otherwise with respect to the securities or obligations of such companies.

Source: *Preliminary Report* of the company, February, 1934.

EXHIBIT 2

THE NEW YORK CENTRAL RAILROAD COMPANY

INCLUDING ALL LINES OPERATED UNDER LEASE

INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1933	1932	1931	1930
Railway Operating Revenues:				
Freight	$194,286,543	$193,328,132	$245,897,087	$307,177,575
Passenger	53,231,808	60,151,922	86,304,508	111,184,745
Mail	10,818,328	11,602,434	12,348,067	13,000,882
Express	6,236,949	7,317,117	11,517,760	14,675,189
All other	18,767,474	21,236,535	26,122,761	32,879,957
Total	$283,341,102	$293,636,140	$382,190,183	$478,918,348
Railway Operating Expenses:				
Maintenance of Way and Structures	25,737,773	28,286,249	48,391,853	64,832,896
Maintenance of Equipment:				
Depreciation (Note 1)	6,439,095	13,979,816	25,958,651	25,209,411
Retirements (Note 1)	8,200,278	9,143,294	440,822	1,651,327
Repairs and All Other	44,244,527	41,663,751	55,110,452	76,896,655
Traffic	5,898,397	6,788,435	8,862,831	9,594,315
Transportation	101,722,945	110,546,897	146,301,549	174,455,031
General and All Other	15,680,279	16,768,178	21,999,523	24,089,783
Total	$207,923,294	$227,176,620	$307,065,681	$376,729,418
Net Revenue from Railway Operations	75,417,808	66,459,520	75,124,502	102,188,930
Operating Ratio	73 38	77.37	80.34	78 66
Railway Tax Accruals	$ 26,456,637	$ 30,083,642	$ 32,215,329	$ 34,009,020
Net Debits for Equipment and Joint Facility Rents, etc	15,692,009	15,562,891	14,833,595	10,944,383
Net Railway Operating Income	$ 33,269,162	$ 20,812,987	$ 28,075,578	$ 57,235,527
Nonoperating Income, etc. (Note 2)	21,522,138	23,684,035	35,816,293	39,763,106
Gross Income	$ 54,791,300	$ 44,497,022	$ 63,891,871	$ 96,998,633
Deductions from Gross Income:				
Rent for Leased Roads (Note 2)	26,423,122	25,659,830	26,383,109	27,762,047
Interest on Funded Debt	28,153,486	28,348,690	28,159,311	27,217,660
Interest on Unfunded Debt	3,792,578	3,988,230	2,067,980	1,414,407
All Others	1,834,628	4,756,672	4,851,370	4,622,727
Total	$ 60,203,814	$ 62,753,422	$ 61,461,770	$ 61,016,841
Net Income			$ 2,430,101	$ 35,981,792
Net Deficit	$ 5,412,514	$ 18,256,400		

NOTE 1: It is expected that for the year 1934 depreciation charges will be not less than $15,700,000 and that charges for retirements will be made direct to surplus, subject to the authorization of the Interstate Commerce Commission.

NOTE 2: Included in Nonoperating Income and Rent for Leased Roads are certain inter-company transactions representing credits and corresponding debits amounting to $6,017,006 in 1933, $5,900,105 in 1932, $5,909,016 in 1931, and $6,925,897 in 1930.

Also included in Nonoperating Income are items representing interest and dividends amounting to $2,033,155 in 1933, $1,975,754 in 1932, $1,828,084 in 1931, and $1,674,432 in 1930 received on securities of and advances to terminal and other railroad companies whose properties are jointly used by this company, as to the major portion of which a like amount was paid by the company to those companies as rental and included in Joint Facility Rents.

Source: *Preliminary Report* of the company, February, 1934.

EXHIBIT 3
THE NEW YORK CENTRAL RAILROAD COMPANY
BONDS PLEDGED WITH TRUSTEE

$48,000,000	Principal amount, of The New York Central Railroad Company Consolidation Mortgage 4% Bonds of Series C, due February 1, 1998
6,000,000	Principal amount, of The New York Central and Hudson River Railroad Company First Mortgage 3½% Bonds, due July 1, 1997
4,500,000	Principal amount, of Boston and Albany Railroad Company 6% Refunding Bonds of 1934, due May 1, 1946, guaranteed as to principal and interest by The New York Central Railroad Company
3,205,000	Principal amount, of The Cleveland, Cincinnati, Chicago and St. Louis Railway Company 5% Refunding and Improvement Mortgage Bonds, Series D, due July 1, 1963
6,171,000	Principal amount, of The Michigan Central Railroad Company 4½% Refunding and Improvement Mortgage Bonds, Series A, due January 1, 1947
7,500,000	Principal amount, of The New York Central Railroad Company 5% Refunding and Improvement Mortgage Bonds, Series C, due October 1, 2013

Source: *Commercial and Financial Chronicle.*

EXHIBIT 4
DEBT* OF THE NEW YORK CENTRAL RAILROAD COMPANY
AND ITS LESSOR COMPANIES MATURING
WITHIN THE SUCCEEDING TEN YEARS

Year 1934:	
Mortgage Bonds and Debentures	$56,594,000
Equipment Trust Obligations	14,627,344
Other Obligations	14,753
Year 1935:	
Mortgage Bonds and Debentures	$21,560,200
Equipment Trust Obligations	14,627,344
Secured Notes, Reconstruction Finance Corporation and the Railroad Credit Corporation	20,400,000
Other Obligations	14,747
Years 1936 to 1943, Inclusive:	
Mortgage Bonds and Debentures†	$36,687,100
Equipment Trust Obligations	50,094,000
Secured Notes, Reconstruction Finance Corporation	9,478,737
Other Obligations	5,117,975

* Excluding bank and other demand loans amounting to $64,400,000.
† Excluding $9,888,500 of funded debt of The Peoria & Eastern Railway Company, the properties of which are operated by The New York Central Railroad Company under contract.
Source: *Preliminary Report* of the company, February, 1934.

EXHIBIT 5
THE NEW YORK CENTRAL RAILROAD COMPANY
PRICE RANGE OF THE COMMON STOCK

Date	High	Low
1934:		
February	45¼	37⅜
March	39¾	34
Week ending:		
April 7	36¾	35⅜
14	37½	35½
21	36¾	34⅝
28	35½	33¾
May 5	31½	28⅝
12	29⅜	25¾
19	29½	25⅜
26	29¼	26¾
June 2	29¼	25⅞

Sources: Quotations for February and March from *Bank and Quotation Record;* quotations for April, May, and June from *The Annalist.*

EXHIBIT 6
THE NEW YORK CENTRAL RAILROAD COMPANY
PRICE RANGE OF THE TEN-YEAR 6% CONVERTIBLE BONDS OF 1944
(Quoted on a "when issued" basis prior to May 17, 1934)

Date	High	Low
1934:		
February	118¾	115¾
March	122½	115¼
April	120¼	114¼
Week ending:		
May 5	115¾	112⅞
12	115⅛	110⅛
19	116⅜	115½
26	117¼	115¾
June 2	117¾	116¼

Sources: Quotations for February, March, and April from *Bank and Quotation Record;* quotations for May and June from the New York *Times.*

5. SACO-LOWELL SHOPS

EXTENSION OF NOTES IN 1933

In the fall of 1932 the directors of the Saco-Lowell Shops realized that the company would be unable to meet $2,661,690 of notes, maturing in January, 1933. Of these, $2,184,000 were three-year 6% Class A notes, issued in 1927 for the purpose of refunding bank loans. In a readjustment of the company's financial obligations in 1929, the Class A notes were extended for three years. At this same time, the maturity date of the remainder, consisting of 7% convertible notes due in 1932, was postponed to 1933.

Since money market conditions and the company's weakened credit position made refunding impossible in 1932, the directors decided to present a plan whereby the maturity of the notes could again be extended for three years and the other obligations of the company arranged in maturities which would give freedom from financial pressure in the near future. In view of the fact that all the Class A notes were held by three banks, and the other obligations were closely held by officers, directors, and principal stockholders, direct negotiations were feasible. The plan, as finally agreed upon and put into effect, is outlined in Exhibit 1.

Incorporated originally in 1845 as the Lowell Machine Shops, the company became the Saco-Lowell Shops upon acquisition of the Saco Pettee Company in 1912. The company manufactured cotton-textile machinery which had been generally recognized as of high quality for many years. Until the beginning of the textile depression in 1923, the company operated successfully, paying cash dividends on its common stock, which ranged from 6 to 12% in the years 1917 through 1923. In 1922, moreover, a common stock dividend of 50% and a second preferred stock dividend of 50% were paid on the common stock. Regular dividends of 6% on the preferred stock were maintained until July 1, 1925.

From 1919 to 1923 the company carried on a program of expansion of plant capacity which it financed by the sale of common and preferred stock, by bank loans, and by the reinvestment of earnings. This expansion proved unwise since at that time the textile industry began to experience a period of depression. During the World War and for several years thereafter, capacity had been greatly increased to meet the requirements of foreign markets.

With the subsequent loss of these markets to Japan, England, and Germany, the textile industry found itself with capacity to produce far in excess of demand for its products. This situation reacted unfavorably on the Saco-Lowell Shops when machinery from bankrupt companies began to compete with its products in an already failing market. The company's losses before depreciation in the years from 1923 to 1926, for instance, ranged from $786,740 in 1924 to $441,644 in 1926.

In 1927, to cope with these conditions and to save the company, the creditor banks installed a new management. Under the new leadership a thorough readjustment of the company's affairs was effected. Certain plants were abandoned; inventories were written down; and bank debt was replaced by notes with maturities of three to five years. Despite substantial losses in every year except 1929, as shown in Exhibit 3, the funded debt was reduced from over $6,000,000 in 1927 to about $3,000,000 at the end of 1932 without impairing the company's current position.

At the close of 1932 there were only three important companies in the cotton-textile machinery industry, as compared with nine in 1920. Whereas at their peak cotton spindles in place in the United States in July, 1925, reached a total of nearly 38,000,000, by 1932 this figure had been reduced to about 32,000,000, a decrease of nearly 16%.

In the annual report for 1931, released March 14, 1932, the president made the following statement:

> Even under the abnormal and depressed conditions which prevailed during the past year, the demand for cotton products was large enough to keep the spindleage in place operating at more than 80% of single-shift capacity, calculated in terms of spindle hours by the U. S. Census Bureau. In 1929 the corresponding figure was about 105% of single-shift capacity with a somewhat larger number of spindles in place.
>
> More than half the spindleage in place today is obsolete in design and much of it is largely worn out and in urgent need of replacement. With even a moderate improvement in general business, it would seem that the industry would require permanent plant capacity of from 25,000,000 to 30,000,000 spindles in place to supply the demand for cotton products, which up to 1929 was slowly but steadily increasing. Under normal conditions the proper maintenance and replacement of a machinery capacity of even 25,000,000 spindles (which is 7,000,000 spindles less than the number now in place, and a reduction of one-third from the peak spindleage of 1925) would provide a sufficient and sustained volume of business to the three companies remaining in our field.

Hundreds of mills today are feeling acutely their need for new and better machinery. . . . Nevertheless, it is clear that there can be no revival of new equipment buying in substantial volume until at least a considerable number of the cotton mills of the country recover some moderate earning power.

Current statements, as shown in Exhibit 2, indicated the precarious position of the company's finances, with large blocks of funded debt coming due in the next few months and an extensive accumulation of preferred dividends.

Notwithstanding these adverse factors the management believed that the future of the industry, as well as the position of the Saco-Lowell Shops therein, amply justified an attempt to preserve the company without a drastic reorganization.

1. Was the plan as given in Exhibit 1 an expedient method of meeting the financial situation?
2. Should a more drastic reorganization have taken place?
3. Was the plan fair to all the interested groups?

EXHIBIT 1

SACO-LOWELL SHOPS

PLAN FOR ADJUSTMENT OF INDEBTEDNESS, DECEMBER 8, 1932

As Approved by the Board of Directors, January 11, 1933, and as Duly Declared Effective on January 14, 1933

PURPOSE OF PLAN

In January, 1933, there will fall due the company's 6% Class A notes and the company's 7% convertible notes (now outstanding, respectively, in principal amounts of $2,184,000 and $477,690). The purpose of the within plan is to postpone the maturities of these obligations on the terms and conditions hereinafter set forth.

EFFECTIVE DATE OF PLAN

The plan will not become effective until the following security holders shall have accepted the same and deposited or agreed to deposit their notes for exchange as herein provided with Old Colony Trust Company, clearing agent: 100% of the Class A notes outstanding after the redemption hereinafter referred to; 100% of the Class B notes outstanding on January 15, 1933; substantially all of the convertible notes outstanding on said date; and until declared effective by the president of the company pursuant to authorization by the board of directors.

EXISTING NOTE INDEBTEDNESS OF THE COMPANY AS OF DATE OF PLAN

a. The Class A Notes.—$2,184,000 (of an authorized issue of $3,412,500). Three-year 6% Class A notes, due January 14, 1933. The balance of the authorized issue has, since January 14, 1930, been redeemed prior to its maturity and canceled.

b. Credit Line Notes.—The company was authorized, in order to raise additional working capital for current operating needs, to issue from time to time not exceeding $470,000 principal amount of these notes, bearing interest at 6% per annum, maturing at or prior to January 14, 1933, and ranking on an equality with the Class A notes. No said credit line notes have been issued to date or will hereafter be issued.

EXHIBIT 1 (*Continued*)
SACO-LOWELL SHOPS
PLAN FOR ADJUSTMENT OF INDEBTEDNESS, DECEMBER 8, 1932

c. The Convertible Notes.—$477,690 (of an authorized issue of $478,120) Three-year 7% convertible notes, due January 15, 1933. The balance of the authorized issue was never issued.

These notes are now convertible into common stock on the basis of $10 a share and are, as to the payment of principal, subordinated to the payment of principal of and interest on the Class A notes and the credit line notes.

d. The Class B Notes.—$895,000 (total authorized issue) Five-year 5% Class B notes, due January 15, 1935.

These notes, as to the payment of principal and as to the payment of 2% interest in excess of 5% per annum, are subordinated to the payment of principal of and interest on the Class A notes, the credit line notes, and the convertible notes. Since January 15, 1927, there has accrued upon these notes, and upon similar notes for which these notes were exchanged, additional interest at the rate of 2% per annum, which interest by the terms of said notes is similarly subordinated and is payable only when the principal of said notes is payable.

PROPOSED ADJUSTMENT OF EXISTING NOTE INDEBTEDNESS OF THE COMPANY

a. The Class A Notes.—On or before maturity, the company will redeem and pay a further $910,000 principal amount of the Class A notes. The balance of said notes thereafter outstanding (*i.e.*, $1,274,000) will be exchanged on January 14, 1933, for Class A notes, dated January 14, 1933, maturing January 14, 1936, and bearing interest to said maturity or prior payment at the rate of 5% per annum.

The Class A notes to be outstanding after January 14, 1933, may be redeemed at par, in whole or in part, prior to maturity, but any redemption prior to maturity of less than all said Class A notes shall be made in ratable proportion to the principal amounts of the said notes at the time held by the several holders.

b. Working Capital Notes.—In lieu of said credit line notes, the company will be authorized from time to time to issue not exceeding $800,000 principal amount of working capital notes, which shall mature not later than January 14, 1936, shall bear such rate of interest and have such security as may be agreed upon, and shall otherwise rank on an equality with the Class A notes. The company has a definite commitment from certain banks to take, at any time upon the company's request, $200,000 principal amount of working capital notes and has further conditionally arranged with said banks for lines of credit aggregating $600,000 (to be used only in the event of increased business requiring additional working capital for current operating needs), advances against which shall be evidenced by working capital notes.

Reference below in the plan to Class A notes includes reference to any working capital notes which may be outstanding.

c. The Convertible Notes.—On January 16 (as of Sunday, January 15), 1933, not exceeding 15% in principal amount of said notes then outstanding will be exchanged for Class C convertible notes below described, and the balance of said notes then outstanding not so exchanged will on said date be exchanged for Class D convertible notes below described.

The aforesaid Class C and Class D convertible notes will be dated January 15, 1933, will mature January 15, 1936, and will be convertible into common stock on a basis similar to that now existing with respect to the convertible notes now outstanding.

The aforesaid Class C convertible notes, as to the payment of principal only, will be subordinated to the payment of principal of and interest on the Class A notes to be outstanding after January 14, 1933. The aforesaid Class D convertible notes, as to the payment of principal and as to the payment of interest at the rate of 7% per annum, will be subordinated to the payment of principal of and interest on said Class A notes.

d. The Class B Notes.—On January 16 (as of Sunday, January 15), 1933, this entire issue will be exchanged for Class B notes, dated January 15, 1933, and maturing January 15, 1936.

EXHIBIT 1 (*Continued*)
SACO-LOWELL SHOPS
PLAN FOR ADJUSTMENT OF INDEBTEDNESS, DECEMBER 8, 1932

The Class B notes so to be issued in exchange (*a*) as to the payment of principal and as to the payment of interest at the rate of 7% per annum, will be subordinated to the payment of principal of and interest on the Class A notes to be outstanding after January 14, 1933, and (*b*) as to the payment of principal and as to the payment of 2% interest in excess of 5% per annum, will be subordinated to the payment of principal of and interest on the aforesaid Class C and Class D convertible notes.

The payment of the interest accrued, at the rate of 2% per annum, from January 15, 1927, to January 15, 1933, upon the Class B notes now outstanding, and upon similar notes for which said notes were exchanged, will be subordinated to the payment of principal of and interest on the Class A notes to be outstanding after January 14, 1933, and to the payment of principal of and interest on the aforesaid Class C and Class D convertible notes.

NOTE: Interest accruals on Class D convertible notes and Class B notes shall bear interest (the payment of which shall be deferred and subordinated) at the rate of 5% per annum.

MISCELLANEOUS

1. The Class A notes, convertible notes, and Class B notes now outstanding were issued under a trust indenture, dated January 14, 1930. The Class A notes, Class C and D convertible notes, and Class B notes to be exchanged therefor under the plan, and the working capital notes provided for in the plan will be issued under a substantially similar trust indenture, which will contain appropriate provisions to carry the plan into effect. This trust indenture will also provide that, as long as any of the Class A notes so to be issued in exchange remain outstanding and unpaid:

a. Except for the purpose of securing working capital notes, no lien of any kind shall be placed on any assets of the company.

b. If the company declares or pays any dividend upon its shares of stock of any class, forthwith there shall become due and payable the entire principal amount of said Class A notes then outstanding.

c. If the amount by which the aggregate of the company's cash, accounts and notes receivable, and inventory exceeds the company's current liabilities, as shown by any monthly statement of the company, shall be no greater than the total principal amount of Class A notes then outstanding, and if within 25 days next following the last day of any month with respect to which such statement is rendered there shall not have been filed with the trustee the writing hereinafter referred to, then at the expiration of said twenty-fifth day a default shall occur and the Class A notes then outstanding shall forthwith become due and payable; *provided however*, that if there shall be filed with the trustee by the holders of at least 75% in principal amount of Class A notes then outstanding a writing, in such forms as the trust indenture may provide, such default shall be postponed, and such default shall thereafter occur six months from the twenty-fifth day aforesaid, if the amount by which the aggregate of the company's cash, accounts and notes receivable, and inventory exceeds the company's current liabilities, as shown by the monthly statement rendered with respect to the sixth month following the month first above referred to, shall be no greater than the total principal amount of Class A notes then outstanding, and *provided further* that during any such period of six months following the filing of such writing no default under this provision shall be deemed to have occurred with respect to any intervening monthly statement.

d. The company will, within sixty days of the end of its fiscal year, redeem and pay a principal amount of said Class A notes then outstanding equivalent to 50% of its net profits for the prior fiscal year as shown in its annual audited statement for said prior fiscal year.

2. In connection with the consolidation of its manufacturing operations at Biddeford and Saco, Maine, and the plant extension incident thereto, the company incurred indebtedness, not exceeding $375,000 in principal amount and payable

EXHIBIT I (*Continued*)
SACO-LOWELL SHOPS
PLAN FOR ADJUSTMENT OF INDEBTEDNESS, DECEMBER 8, 1932

with interest in ten equal annual installments (first installment due January 1, 1933). By appropriate instruments executed at the time of said consolidation, it is provided that, upon the happening of a default under the trust indenture above-mentioned, all payments on account of said indebtedness are subordinated to the payment in full (pursuant to the provisions of said trust indenture) of principal of and interest on the Class A notes to be outstanding after January 14, 1933.

3. Decisions by the board of directors as to questions arising in carrying the plan into effect (not affecting the substance thereof) shall be conclusive. If and when the plan becomes effective, the physical exchange of securities contemplated in the plan may be delayed temporarily after the date specified in the plan, provided that such exchange when made be made as of said specified date.

EXHIBIT 3
SACO-LOWELL SHOPS
CONSOLIDATED INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1928	1929	1930	1931	1932
Operating profit	$382,067	....	$254,116[d]	$121,611	$204,679[d]
Depreciation	360,088	....	290,426	291,251	254,179
Idle plant expense	51,877	....	70,645	56,423	52,459
Interest	366,229	....	275,153	259,888	249,685
Consolidation expense	361,734				
Reserves	135,000				
Net profit	$892,861[d]	$1,004,034	$890,340[d]	$485,951[d]	$761,002[d]

NOTE: In 1927 the company made a profit of approximately $61,000 before depreciation and inventory adjustment, but after interest.
[d] Deficit.
Source: Company reports.

6. GENERAL REFRACTORIES COMPANY

REFINANCING NOTES DUE IN 1933

Early in 1933 a committee, representing over one-third of the holders of the $5,000,000 two-year 5% gold notes of the General Refractories Company, maturing March 1, was formed to protect the interests of this group and to present a plan for refinancing the notes.

As the result of a number of mergers of small, locally owned companies which were engaged in the manufacture of firebrick and allied refractory products, the General Refractories Company had become the second largest organization in the industry. The company owned and operated 15 plants, many of which specialized for the most part on particular products. In addition, it possessed extensive mineral property, which supplied the majority of the raw materials consumed in these plants; the remaining minerals required were obtained from abroad under favorable contracts.

From its incorporation in 1922 the company operated successfully until 1931, with net profits increasing from $815,273 in 1923 to $2,553,123 in 1929; net earnings were over $1,000,000 every year except 1923 and 1924. Operating results for the years 1928 through 1932 are shown in Exhibit 2.

Although the company had accomplished its expansion chiefly by exchange of stock and reinvestment of earnings, in 1931 in order to provide funds for the purchase of five plants and additional mineral lands, a $5,000,000 issue of two-year 5% gold notes was sold. By the time they fell due in March, 1933, however, the company had not accumulated sufficient funds to meet the maturity of these notes, a situation which was attributed to prevailing business conditions. Heretofore the refractories industry had been considered to be "depression proof" since 45 to 50% of its output was taken by the iron and steel industry, in which repairs were usually made in slack times when furnaces were out of production.

Recognizing that, under the circumstances, refunding of the notes by the sale of securities to the public was out of the question, the noteholders' committee presented to the directors of the company the plan which is summarized in the following paragraphs:

The principal features of the plan are (1) payment of $5,000,000 of two-year 5% gold notes due March 1, 1933; (2) the issuance of $6,000,000 of five-year 6% first mortgage cumulative income bonds; (3) the issuance of stock purchase warrants for 240,000 shares of stock at $5 per share, attached to said bonds; (4) the issuance of 54,000 additional shares of stock, as compensation for deferred payment of interest; (5) the creation of a voting trust agreement which provides for the issuance of voting trust certificates for stock in accordance with a voting trust agreement.

1. The $5,000,000 of two-year 5% gold notes were issued March 2, 1931, and mature March 1, 1933. These notes were issued in connection with the acquisition of five additional plants and additional mineral properties in 1931.

2. In payment of the above gold notes the issuance of $6,000,000 of five-year 6% first mortgage cumulative income bonds, to be dated March 1, 1933, and to mature March 1, 1938, was authorized by the board of directors January 14, 1933, and offered to stockholders of record as of the close of business at 3 P.M., February 10, 1933. A special meeting of the stockholders of the company was held at 12 o'clock noon, March 22, 1933, for the approval or disapproval of the issuance of these bonds. These bonds will be secured by a closed mortgage upon the present properties of the company and by the further pledge of its 40% stock interest in the Northwest Magnesite Company. Interest upon these bonds will be payable out of net earnings of the company. The bonds will be redeemable in whole or in part at any time upon 45 days' notice, at par and accrued interest. The mortgage indenture securing these bonds will contain a provision that no dividends will be paid on the stock of the company so long as the bonds are outstanding. In the event of an oversubscription, these bonds will be allotted to stockholders; all unsubscribed bonds, up to a total of $5,000,000, will be offered in exchange for the 5% gold notes due March 1, 1933, par for par. Of the remaining $1,000,000 in bonds $325,000 will be set aside as security for the company's present $325,000 bank loans. The remaining $675,000 will be used for additional working capital and for other corporate purposes.

3. Each $1,000 mortgage bond will carry a nondetachable warrant giving to the holder thereof the right to purchase 40 shares of stock at $5 per share at any time during the life of the bond. In the event of redemption of the bonds prior to maturity the holders thereof will have the privilege of exercising these stock warrants up to but not on or after the date fixed for redemption.

4. One share of stock will be issued to the holders of the above bonds, as compensation for the postponement of the payment of interest thereon, for each semiannual interest coupon which shall not be paid at the end of each semiannual period.

5. A voting trust will be created for the capital stock of the company, to continue during the term of the bonds, and voting trust certificates, up to a total of 594,000 shares, will be issuable in accordance with the terms of a voting trust agreement, as more fully described herein.

VOTING TRUST AGREEMENT

Purpose.—The purpose of the voting trust agreement is to unite the voting rights of the stockholders and the voting trustees for the management of the company in the best interests of the stockholders and the bondholders.

Dissent and Withdrawal.—The agreement provides that stockholders depositing their stock in the voting trust shall thereby vest in said voting trust all voting powers with respect to such stock. The agreement does not provide for withdrawal by stockholders.

Adoption.—The agreement is immediately effective as to the stockholders executing the same and no specified percentage of stockholders is therein required for adoption; said agreement, however, is an integral part of the general refinancing plan which includes the $6,000,000 five-year 6% first mortgage cumulative income bonds above mentioned.

Powers and Duties of Voting Trustees.—The voting trustees shall have all the powers of stockholders in the voting of stock deposited under the voting trust agreement, excluding the right to sell and dispose of such shares, the voting trustees agreeing to perform the duties and trusts proposed in the agreement.

Designation of Voting Trustees.—Two voting trustees are designated by the holders of the company's five-year 6% first mortgage cumulative income bonds, due March 1, 1938, and one by the principal stockholders of the company. In the case of a vacancy in the number of voting trustees, the successor shall be appointed (*a*) if the voting trustee so ceasing to act be one of the voting trustees nominated by the holders of the company's five-year 6% first mortgage cumulative income bonds, by the remaining voting trustee nominated by the aforesaid bondholders; (*b*) if the vacancy in the voting trust be the voting trustee nominated by the stockholders of the company, by the board of directors of the company from among the then registered holders of voting trust certificates issued under this agreement.

An additional feature of the plan involved a three-year contract with a group of banks whereby the company was assured of additional working capital, if needed, up to the maximum amount of $500,000.

After ratification by the directors of the company on January 14, 1933, the plan, as outlined, was approved by the stockholders, February 10; by March 22, $4,566,000 of the notes had been deposited as specified.

In accordance with the Voting Trust Agreement, Mr. A. R. Horr, vice president of the Cleveland Trust Company, Mr. Alfred Hurrell, vice president of the Prudential Life Insurance Company of America, and Hon. William I. Schaffer, Justice of the Supreme Court of Pennsylvania, were appointed as voting

trustees, the first two representing the bondholders, and the last, the stockholders.

Under the direction of this new board of control several important changes were made in the management and the directorate. The size of the latter board was reduced from 17 to 9 members, four of whom were new members. By the end of the year, moreover, Mr. S. M. D. Clapper, who had no previous direct connection with the company, had replaced Mr. John R. Sproul as president.

1. Compare the plan for meeting the maturity of the General Refractories two-year 5% gold notes due March, 1933, with the plan offered in January, 1933, to the noteholders of the Saco-Lowell Shops.

2. In view of the financial position and prospects of the two companies which plan (*a*) was the more equitable to all interests concerned, (*b*) was the more effective in improving the financial position of the companies involved?

3. In your opinion could more satisfactory plans for meeting the situation with which the two companies were confronted have been put into effect? If so, what changes would you recommend in the plans as adopted?

EXHIBIT I
GENERAL REFRACTORIES COMPANY
CONDENSED BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932
ASSETS				
Cash	$ 973,522	$ 605,700	$ 415,605	$ 237,604
Notes Receivable—Northwest Magnesite Company	...	...	250,000	250,000
Notes Receivable—Customers, Individuals, etc.	405,630	74,363	72,111	74,581
Accounts Receivable (Net)	1,385,271	1,099,764	790,043	543,137
Inventories, at Lower of Cost or Market	2,754,121	3,212,831	3,126,361	1,855,391
Accrued Interest Receivable	46,160	85,898	13,995	2,404
Investments, Marketable (at Cost)*	170,213	183,596	173,882	173,882
Total Current Assets	$ 5,734,917	$ 5,262,152	$ 4,841,997	$ 3,136,999
Miscellaneous Investments (at Cost)	808,522	824,698	2,382,354†	829,580
Notes Receivable—Officers and Employees—Partly Secured	2,716	1,050,901	1,034,986	1,231,767
Deferred Accounts	433,528	472,440	553,869	275,334
Patents at Cost	28,851	37,250	34,873	31,641
Real Estate, Buildings, Machinery, etc., Net of Allowance for Depreciation and Depletion	15,296,256	18,677,942	18,366,450	17,978,877
Cash in Banks in Hands of Receivers	...	...	24,501	21,365
Total Assets	$22,304,790	$26,325,383	$27,239,030	$23,505,563
LIABILITIES				
Bills Payable—Banks	...	$ 3,105,000	$ 250,000	$ 325,000
Accounts Payable	$ 140,763	440,976	197,661	143,970
Accrued Accounts	186,949	171,694	193,237	179,047
Allowance for Federal Income Tax	200,000	242,500		
Total Current Liabilities	$ 527,712	$ 3,960,170	$ 640,898	$ 648,017
Two-year 5 % Gold Notes, March 1, 1933	...	...	5,000,000	5,000,000
Reserve for Contingencies	...	...	...	1,750,000
Capital Stock	12,951,696	12,951,696	12,951,696	11,350,002
Paid-in Surplus	5,175,510	5,052,057	4,948,156	4,757,544
Earned Surplus	3,649,872	4,361,460	3,698,280	
Total Liabilities	$22,304,790	$26,325,383	$27,239,030	$23,505,563

* Market Value, 1930, $156,000; 1931, $45,900; 1932, $33,300.
† Includes treasury stock, market value $510,125.
Source: Company reports.

EXHIBIT 2
GENERAL REFRACTORIES COMPANY
CONDENSED STATEMENT OF OPERATIONS, YEARS ENDED DECEMBER 31

Item	1928	1929	1930	1931	1932
Earnings from operations, before taxes, interest, etc.	$1,862,284	$2,937,103	$2,629,174	$749,539	$ 452,225[d]
Miscellaneous income	199,222	236,669	258,054	166,131	140,253
Earnings before taxes, interest, depreciation and depletion	$2,061,506	$3,173,772	$2,887,228	$915,670	$ 311,972[d]
Corporate, municipal, income taxes	166,114	262,683	334,660	82,298	84,265
Interest on bonded debt	219,511	83,050			250,000
Interest on floating debt	45,866	13,335	101,684	294,570	19,909
Bond discount and expenses	23,280	....			77,148
	$1,606,735	$2,814,704	$2,450,884	$538,802	$ 743,294[d]
Depreciation and depletion	232,154	261,581	314,296	301,982	278,792
Extraordinary losses	....	....	....	....	1,001,051*
Net profit	$1,374,581	$2,553,123	$2,136,588	$236,820	$2,023,137[d]
Cash dividends	675,000	1,200,000	1,425,000	900,000	
Profit after dividends	$ 699,581	$1,353,123	$ 711,588	$663,180[d]	$2,023,137[d]
Shares outstanding	225,000	300,000	300,000	300,000	262,900
Earnings per share	$6.11	$8.51	$7.12	$0.79	Nil

* Chiefly inventory revaluation.
[d] Deficit.
Source: Company reports.

7. EPERNAY TEXTILE COMPANY

REFINANCING MATURING NOTE ISSUE

In March, 1934, the directors of the Epernay Textile Company faced the problem of refinancing $2,088,000 of 7% convertible mortgage bonds, since the company's working capital position was not sufficiently strong to permit their being paid off at maturity on April 1, 1934.

Originally manufacturing only cotton textiles, the Epernay Textile Company, which operated plants in Massachusetts, Connecticut, and Pennsylvania, entered the field of rayon production in 1923. From then on, it gradually increased its rayon capacity until, early in 1934, the major part of its output consisted of rayon yarn and fabrics. In the rayon industry this company was regarded as one of the more progressive, though smaller, organizations since it had maintained a policy of promptly replacing obsolete machinery to keep abreast of the continual improvement in manufacturing methods.

EXHIBIT 1
RAYON YARN PRODUCTION
(In thousands of pounds)

Year	United States	World
1912	1,110	19,800
1916	5,780	23,400
1918	7,385	25,900
1921	14,990	48,200
1922	23,700	75,995
1923	34,495	103,555
1924	36,330	142,715
1925	51,900	186,320
1926	62,690	214,840
1927	75,555	298,955
1928	97,230	369,020
1929	121,285	443,225
1930	126,805	453,336
1931	150,880	499,340
1932	134,815	530,220
1933	207,580	659,500

Source: *Textile Organon*, June, 1934, p. 83.

Exhibits 1, 2, and 3 show the growth of the rayon industry since 1912 and give some indication of its statistical position

early in 1934. The company's operating results for 1931, 1932, and 1933 are given in Exhibit 4.

EXHIBIT 2
ANNUAL FIBER CONSUMPTION
UNITED STATES
(In millions of pounds)

Year	Cotton	Wool	Silk	Rayon
1920	2,822	289	28	10
1923	3,117	401	48	32
1926	3,215	319	67	61
1929	3,426	366	82	131
1930	2,608	269	77	117
1931	2,657	321	79	157
1932	2,458	241	74	152
1933	3,031	324	62	207

Source: *Textile Organon*, February, 1934, p. 26.

EXHIBIT 3
LIST PRICES OF UNITED STATES VISCOSE RAYON ON SELECTED DATES, 150 DENIER, FIRST QUALITY, 24 FILAMENT
(In dollars per pound)

February 1, 1925	$2.00
July 1, 1926	1.65
April 1, 1927	1.50
June 18, 1929	1.15
June 22, 1930	0.95
January 9, 1931	0.75
May 26, 1932	0.65
June 21, 1932	0.55
April 3, 1933	0.50
April 26, 1933	0.55
July 1, 1933	0.65

Source: *Textile Organon*, July, 1934, pp. 96–97.

The 7% convertible mortgage bonds were issued in 1929 to raise funds for the acquisition of a rayon plant and were secured by a mortgage on the purchased property. At the end of 1933 the mortgaged property was carried on the books of the company at a depreciated value of about $5,000,000. No sinking fund had been provided for retirement of the bonds, but they were at any time convertible into common stock on a basis of 10 shares of stock per $1,000 bond and were callable at 105 on any interest date. Various plans for refinancing this maturing debt were advanced, of which the following received the strongest support:

1. A well-known investment banking house offered to float an issue of $2,400,000 five-year 7% refunding convertible mortgage bonds; its legal advisers stated that this was technically possible under the Securities Act. The new issue, convertible into common stock at the rate of 25 shares per $1,000 bond, was to be secured by a first mortgage on substantially all the company's property with additional bonds issuable only in connection with the acquisition of new property or the construction of new plants. The proposed refunding 7s were to be callable at 105 on any interest date on 90 days' notice.

2. One of the directors proposed selling a bond issue in a foreign country, Holland, for example.

3. Several of the directors believed that bondholders should be asked to extend the maturity date of their bonds for one year. The company would covenant not to mortgage any of its properties so long as the extended bonds were unpaid. If this plan were adopted, its supporters believed that from one-fourth to one-half of the bonds would be turned in for extension and that the company's banks, from which large loans had been obtained in the past, would advance the funds to pay off bonds not extended.

EXHIBIT 4
EPERNAY TEXTILE COMPANY
INCOME STATEMENT, YEARS ENDED DECEMBER 31

Item	1931	1932	1933
Sales	$9,511,342	$9,168,409	$10,257,589
Cost of goods sold	7,678,280	7,105,127	6,838,993
Gross profit	$1,833,062	$2,063,282	$ 3,418,596
Selling and administrative expense	669,528	615,709	645,490
Loss on bad debts	93,854	68,546	47,710
Maintenance and repairs	734,843	588,888	599,560
Depreciation	1,482,632	1,111,703	1,148,522
Amortization of patents and trademarks	44,188	44,188	65,362
Property taxes and rents	151,812	153,212	143,840
Gross income from trading and manufacturing	$1,343,795[d]	$ 518,964[d]	$ 768,112
Other income	126,340	127,926	253,516
Total income	$1,217,455[d]	$ 391,038[d]	$ 1,021,628
Interest	202,826	191,387	165,125
Cash discount on sales	207,692	200,429	209,250
Research expenses	74,426	86,963	76,643
Other deductions	836,494	478,601	199,132
Net income	$2,538,893[d]	$1,348,418[d]	$ 371,478
Preferred dividends	209,538	209,538	
Additions to surplus	$2,748,431[d]	$1,557,956[d]	$ 371,478

[d] Deficit.

4. As a variant of the third plan, it was suggested that, since the bond indenture carried the right to default technically for 60 days after the maturity date, no action be taken until after April 1. After that date, it was pointed out, the bonds would probably fall to a further discount because of the uncertainty of eventual redemption and could then be purchased in the market with funds which would be borrowed from banks.

EXHIBIT 5
EPERNAY TEXTILE COMPANY
CONDENSED BALANCE SHEET, AS OF DECEMBER 31

Item	1930	1931	1932	1933
ASSETS				
Cash	$ 1,435,448	$ 1,165,680	$ 1,727,231	$ 1,135,576
Accounts Receivable	845,258	587,512	606,088	643,051
Inventories—Finished	4,958,754	2,489,726	1,567,015	1,279,139
Inventories—In Process and Raw		1,113,788	1,034,288	1,046,101
Total Current Assets	$ 7,239,460	$ 5,356,706	$ 4,934,622	$ 4,103,867
Real Estate and Buildings	9,547,070	9,539,789	9,526,634	21,940,060
Machinery and Equipment	12,770,802	12,942,965	13,283,917	
Patents, Trade-marks, and Goodwill	972,071	966,707	962,260	914,441
Investments in Nonaffiliated Companies	546,604	498,004	498,004	1
Deferred Charges	164,860	53,590	67,922	194,290
Other Assets	311,295	361,422	22,332	
Total Assets	$31,552,162	$29,719,183	$29,295,691	$27,152,659
LIABILITIES				
Accounts Payable	$ 473,692	$ 227,623	$ 339,908	$ 785,447
Notes Payable	840,000	420,000		
7% Convertible Mortgage Bonds, Due April 1, 1934	....	....	....	2,088,000
Accruals	298,013	372,087	396,472	185,273
Total Current Liabilities	$ 1,611,705	$ 1,019,710	$ 736,380	$ 3,058,720
7% Convertible Mortgage Bonds, Due 1934	2,400,000	2,400,000	2,400,000	
Reserve for Depreciation	7,222,547	8,896,220	10,230,971	10,393,993
Contingency Reserve	....	....	3,354,655	
Preferred Stock, 7% Cumulative	3,000,000	3,000,000	3,000,000	2,993,400
Common Stock, No Par	7,346,940	7,328,940	515,238*	513,921*
Paid-in Surplus	9,970,970	7,074,313	9,058,447	1,384,961
Capital Surplus				5,184,032
Earned Surplus				3,623,632
Total Liabilities	$31,552,162	$29,719,183	$29,295,691	$27,152,659

* $1 par value.

1. Appraise the four plans proposed for refinancing the maturing bonds.

2. Do the operating statements and balance sheets of the Epernay Textile Company give evidence to support the belief that banks would have advanced sufficient funds for redeeming bonds under Plan 3?

3. Under the assumption that banks would have advanced sufficient funds to put Plan 3 into effect, which of the four plans proposed should have been adopted?

EXHIBIT 6
EPERNAY TEXTILE COMPANY
PRICE RANGE OF THE COMMON STOCK

Date	Low	High
1931	4	28
1932	1	17
1933:		
First half	3	34
July	14	33
August	17	25
September	17	22
October	16	22
November	14	17
December	11	17

EXHIBIT 7
EPERNAY TEXTILE COMPANY
PRICE QUOTATIONS FOR 7% CONVERTIBLE MORTGAGE BONDS

Date	Wants	Offerings
1931:		
November 29	3 @ 96½	
1932:		
March 30	@ 90	@ 100
September 24	@ 70	
September 30	@ 75	
December 30	15 @ 52	
1933:		
January 20	2 @ 52	
February 28	@ 52	
April 29	@ 52	
June 29	....	5 @ 98
July 12	....	5 @ 98
October 25	1 @ market	
November 30	5 @ market	5 @ market
December 27	@ 85	
December 30	5 @ 95	
1934:		
January 8	5 @ 96½	
January 30	5 @ 92½	
February 28	@ 93	

8. BUELL PRODUCTS COMPANY

OFFER OF NEW NOTES FOR MATURING ISSUE

In common with the financial practice of many corporations early in the depression, the Buell Products Company met its maturing note issue of $1,800,000 by the issue of three-year 6% gold notes dated March 1, 1930. Early in 1929 the company had planned to take advantage of the favorable stock market by a substantial issue of common stock in order to retire all notes and to provide additional working capital. The New York bankers who were consulted about the stock financing had insisted upon a specified record of earnings over the preceding five years certified by an auditor of their own choosing. The preliminary audit was enough to show that a physical inventory would have to be taken and further readjustments in the accounts would have to be made before an unqualified certificate could be given. Not until its financial records were reviewed by a local auditing firm was the Buell management finally convinced that the conservatism of the New York auditors was warranted. By October the accountants presented revised statements for 1926 to 1929, giving effect to a revalued physical inventory, liberal obsolescence reserves, write-down of developmental expense, and the elimination of leased items from current assets. By that time the 1929 market had turned, and plans for stock financing were abandoned.

The Buell Products Company, organized in 1894, manufactured a wide line of measuring and weighing apparatus and other precision devices for industrial use. A considerable part of its income came from rentals on apparatus leased to customers under contracts. Favored from the start with competent and aggressive management, it continued to hold a strong competitive position in its major product because of a combination of valuable United States and foreign patents, early leadership in the field, and high-quality products at relatively low prices. Control and management had always been held within the Buell family, Mr. John Buell, the president, having the dominant interest. Progressive and alert management was attested by a record of steady growth in sales and profits and a ready adaptation to new markets and threatened competition. Mr. Buell's exceptional business ability came from the rare combination of engineer-

ing and merchandising skill. His resourcefulness was never more evident than in the way his company directed its attack on depression problems through improvements in product and the development of new products to supply new markets. The company had used both the open-market and established bank lines for its temporary financial needs but had not resorted to borrowing for longer terms until three-year notes were issued in 1921. These had been replaced with new issues when they matured; in 1930 the company again faced a refunding problem. Dividends on its preferred stock had never been passed, and with the exception of 1907 there had been no break in the payment of common dividends. Comparative financial statements from 1929 to 1933 are presented in Exhibits 1 and 2.

In October, 1929, Mr. Buell referred his financing needs to Chicago bankers with a resulting agreement that the Wabash Trust Company would purchase the company's issue of three-year 6% gold notes on March 1, 1930.

In its commitment letter, the Wabash Trust Company inserted a preferential clause giving it a 15-day option at the same price as another banker might offer on any new securities issued by the Buell Products Company. The Wabash Trust Company then agreed to purchase $1,800,000 three-year 6% notes provided the two auditing firms would furnish a joint certification of earnings for the years 1927 to 1929 which would show, available for depreciation and Federal taxes, earnings of not less than $405,000 for 1927, $360,000 for 1928, and $550,000 for 1929. Charge-offs for development expense and liberal obsolescence reserves for inventory were to be made. The company, further, was to supply the bankers with monthly operating statements and to place a banker's representative on its board.

The Wabash Trust Company at once arranged a joint account, equally divided as to liability, with Ingalls and Company, a medium-size banking house in the same city. The net price to this account was 95¾, which allowed ½% to a Chicago dealer and ¼% to the Wabash Trust Company. Further arrangements for distribution of the issue included a selling group, consisting of 17 firms in four cities of near-by states. Four of these firms took more than half of the issue.

Certain restrictive provisions in the indenture for the issue provided that, so long as any notes remained outstanding, the company could not (*a*) create or suffer any mortgage or other

charge upon its property, then owned or thereafter acquired, except purchase money mortgages or liens not in excess of 75% of the cost of the additional property; (*b*) declare or pay any dividends in cash or property on any class of its stock in excess of $125,000 in any calendar year; (*c*) declare any such dividends at any time when its net current assets would be reduced to less than 110% of the aggregate principal amount of its outstanding notes; and (*d*) issue any obligations maturing more than one year after their date without consent of holders of 75% of aggregate principal amount of outstanding notes of this issue. The notes were offered to the public to yield 6%.

The close touch with the company's operations insisted upon by the bankers at the time of the 1930 financing was followed up carefully in 1931 as it became evident that the depression was deepening and no early recovery was in sight. They were particularly watchful of the company's current position and throughout the year repeatedly urged the reduction of inventory so that the proceeds could be used to reduce the notes outstanding, which were currently selling at considerable discounts. In June, 1932, Mr. Buell informed the Wabash Trust Company of his growing concern about the maturity of the notes due in 1933 and indicated that he proposed to draw his own supplemental indenture when the proper time came to negotiate with noteholders about extension of their notes. A short time later he looked with some favor upon a plan for extending the notes which was drawn up by the manager of the bond department of another banking firm in a near-by city. This firm was reputed to have had considerable success in preparing plans for refinancing.

Fearing that premature discussion would be opened with noteholders, the Wabash Trust Company wrote at length to Mr. Buell advising strongly against early suggestion of exchange and emphasizing that it would be well to hold all talk of refinancing plans within the group of the four or five largest participating bankers in the 1930 financing. It was also forcefully stated that shopping around from banker to banker could only injure his credit by too wide a display of his own concern about his financial requirements. He was reminded that the success of any plan would depend upon the whole-hearted support of the principal original participants.

Mr. Buell seemed impressed with these warnings against early and independent action and promptly reported his willingness to

cooperate fully in plans to be worked out with the bankers. As a first step, early in August, 1932, he furnished evidence of the improving condition of his company. He stressed particularly the marked improvement in the current ratio during the first six months of 1932. Bank loans had been entirely paid, and current liabilities had gone down by $287,000. He also reported an improved and more diversified list of products and some startling new developments not yet ready for announcement. Apparently Mr. Buell had become convinced that successful refinancing would depend upon his support of a plan proposed and carried out by the bankers.

By October, 1932, the two firms in the original joint account assumed the full burden of drawing a satisfactory plan and directing the campaign to insure its success. Mr. Buell was urged immediately to retain his regular firm of public accountants to prepare a thorough audit, as of September 30, in order to confirm representations in a plan for a new refunding issue to be prepared and set up in letter form not later than December 1. It was considered particularly important to place full information before the noteholders in this letter with all statements, which might be construed as representations, properly passed upon by the auditors. It was realized that any feasible plan would have to be acceptable to at least 95% of the noteholders, and although the necessity for the extension arose more from conditions in the capital markets, rather than from the distress of the company, the plan must compensate present holders for deferment but still not hinder the company's operations. When the figures for the September 30 audit were available, the bankers with the approval of Mr. Buell prepared a plan which offered new five-year 7% notes dated March 1, 1933, for the outstanding 6s, with additional strengthening features as follows:

1. Each $1,000 holder would get stock warrants, detachable after March 1, 1935, in the ratio of 12 shares for each $1,000 note.
2. Dividend restrictions would be further tightened to prevent common dividends during the life of the new notes.
3. In addition to the then prescribed sinking fund, the company would have to deposit cash with the trustee in equal amounts with any amount declared on the preferred stock.
4. The call price would be 102½ until March 1, 1935, then 100.

All expenses incident to the issue would be borne by the company, including auditing and legal fees for the bankers. The

company agreed to pay the bankers, at the time the plan was declared effective, $2\frac{1}{2}\%$ of par on all notes exchanged; if not declared effective, a flat fee of not over $10,000.

Several circumstances complicated the problem of securing deposits under the plan. With the exception of a few substantial blocks of notes, the majority were in the hands of over 300 holders in the adjoining five states. Personal financial problems made a cash settlement of any sort attractive to a large percentage of these holders. Much personal solicitation was necessary to bring deposits of these notes. Two banks which held large blocks of the notes presented special cases. One, the Central National Bank, a closed bank in the hands of liquidators, held $220,000 of the notes and, while making no specific criticism of the plan, demanded assurance that no noteholder would get cash without a pro rata distribution to the others. The Gibraltar Trust Company, a bank which held $97,000 of the notes, also insisted upon its proportionate share of any cash payment to noteholders. It further demanded restrictions in the indenture that the Buell Products Company should not pledge any of its quick assets for loans and that the lien of the notes should include the lease contracts as well as the fixed property and equipment.

1. Study the provisions included in the new indenture drawn up for the five-year 7% notes as to their effects on the financial position of the company and its stockholders.

2. Outline the contents of a suitable letter, to be sent out by the investment bankers to the holders of the 6% gold notes, which will present convincing reasons for prompt deposit of their notes for exchange.

3. What effective argument could be advanced to the Gibraltar Trust Company against its insistence upon further restrictive clauses in the indenture? What points should be stressed in asking for the deposit of the notes held by the bank in the hands of a liquidator?

EXHIBIT I
BUELL PRODUCTS COMPANY
BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1929	1930	1931	1932	June 30, 1933
ASSETS					
Current:					
Cash	$ 206	$ 177	$ 71	$ 55	$ 114
Customers' Notes Receivable, Less Allowances	734	524	435	448	326
Customers' Accounts Receivable	346	325	320	......	169
Inventory	1,463	1,618	1,450	1,554	1,597
Cash Surrender Value of Life Insurance	57	58	59	60	2
United States Liberty Bonds (at Cost)	.....	75			
Inventory under Lease—Depreciated Book Value	1,952	1,783	1,443	1,181	1,121
Other Assets:					
Customers' Notes Receivable, Maturing Subsequent to One Year	168	95	69	137	92
Investments	129	116	119	71	70
Permanent:					
Land, Buildings, Equipment, etc., Less Allowance for Depreciation	1,602	1,593	1,548	1,320	1,301
Patents—Unamortized, Book Value	308	249	*		
Development Expense, Book Value	354	458	*		
Supplies, Prepaid Items, etc.	46	52	28	21	7
Total Assets	$7,365	$7,123	$5,542	$4,847	$4,799
LIABILITIES					
Current:					
Notes Payable	.....	....	$ 127	......	$ 26
Accounts Payable	$ 180	$ 145	162	$ 7	61
Accrued	130	76	47	42	16
Debt:					
5% Gold Notes Due March 1, 1930	1,800				
6% Gold Notes Due March 1, 1933	. .	1,778	1,660	1,593	
7% Secured Gold Bonds Due March 1, 1938	......	.. ..	... ..	......	1,497
Deferred Income	11	9	14	15	17
Capital Stock:					
Preferred, 6% Cumulative—5,906 shares	591	591	591	591	591
Common, No Par†	1,272	1,272	1,310	1,310	1,310
Surplus	3,381	3,252	1,631	1,289	1,281
Total Liabilities	$7,365	$7,123	$5,542	$4,847	$4,799

* Future expenditures to be charged to current operations. The 1½ % quarterly dividend on preferred due January 1, 1932, omitted.
† Stated value, $10 a share.

EXHIBIT 2
BUELL PRODUCTS COMPANY
INCOME AND EXPENSE STATEMENT, YEARS ENDED DECEMBER 31
(In thousands of dollars)

Item	1929	1930	1931	1932	6 months ended June 30, 1933
Rentals and sales (net)	$3,624	$2,388	$2,058	$1,387	$593
Less: Cost of rentals and sales	1,820	1,145	983	696	263
Gross profit before depreciation	$1,804	$1,243	$1,075	$ 691	$330
Expense:					
Selling expense	637	503	553	387	155
Shipping	14	10	8	5	2
Administrative	97	90	80	62	29
Operating profit before depreciation	$1,056	$ 640	$ 434	$ 237	$144
Other deductions:					
Development expense	119	124	125	6	9
Provision for obsolescence of inventory	......	......	240	132	
Interest other than on debentures and gold notes	12	....	4	3	
Doubtful notes and accounts	36	40	88	38	17
Patent expense	76	5	6	4	
Miscellaneous (net)	3	4	1	12	
Less: Interest earned	31	51	34	18	24
Other deductions (net)	$ 215	$ 122	$ 430	$ 177	$ 2
Profit before depreciation, interest, special charges, and Federal tax	841	518	4	60	142
Depreciation and obsolescence	492	391	373	287	136
Profit before interest and Federal tax	$ 349	$ 127	$ 369[d]	$ 227[d]	$ 6
Interest and expense on debentures and gold notes	110	146	136	98	57
Federal income tax	37	1	....	......	84*
Net profit	$ 202	$ 20[d]	$ 505[d]	$ 325[d]	$ 33

NOTE: The operating results for 1929 and 1930 have been adjusted to show actual expenditures for development and patents, to conform with accounting procedure made effective January 1, 1931.

* Tax refund.

[d] Deficit.

9. WELLAND MACHINERY COMPANY

REFINANCING PROBLEMS DURING SECOND QUARTER OF 1933

Early in 1933, after two years of difficult operating conditions, the Welland Machinery Company was facing a financial emergency which would become acute by May or June because of the maturity of its debentures on July 1. Dollar volume of sales for 1932 was about one-third that of 1930. It would have been difficult in more normal times to effect a satisfactory compromise with six creditor banks, some 200 holders of the $463,000 of debentures maturing July 1, and a number of creditors on merchandise account. The banking crisis of the first quarter of 1933 made the position of the company even more critical. Four of the creditor banks were closed; the conservator or the liquidator in charge of each bank was watchful of every move taken by the company or by any of its creditors. The situation was further complicated by the complete absence of any capital market that would furnish funds to take care of the maturing obligations through a normal refunding program.

The difficult position of the company was hardly to be charged entirely to conditions beyond the control of its management. The nature of its product made financial policy particularly important. As a manufacturer of various types of road-building machinery, its volume was so greatly affected by cyclical movements in the construction industry that financial conservatism during boom times was imperative. Furthermore, with a large percentage of its sales on 15 months' credit the company was compelled to maintain an ample margin of working capital in order to carry the increasing amounts of slow paper that accumulated during a depression.

The Welland Machinery Company, incorporated in 1895, manufactured a complete line of road graders, levelers, plows, cement mixers, and asphalt-laying apparatus. It was estimated that its three plants, completely modern in layout and equipment, would assure the company of ample physical capacity until about 1940 without additional capital expenditure. Branch sales offices in eight centers of the East and South gave ready distribution for its products. Preferred dividends had been paid every quarter until March 1, 1932, inclusive; dividends on the no-par common stock were last paid in March, 1931. Since its organiza-

tion the company had operated at a loss in only two years, the one substantial loss coming in 1932. The financial statements of the company since 1929 are presented in Exhibits 1 and 2.

The company was confident that the return to more normal conditions in highway maintenance and development would bring a quick return of profits as large as they had been before the crash. Sales in this industry ordinarily followed general business conditions, with a slight lag caused by the planning necessary for construction projects. With many of its machines placed over a wide area, the company also expected to benefit through increased repair and spare-part business. In addition, by May, 1933, the promise of large expenditures for public works under the pending Industrial Recovery Bill would have an immediate effect on the demand for all kinds of construction equipment.

It was realized by both the bankers and the company that it would be impossible to raise new money in the demoralized financial markets early in 1933. In the latter part of April, 1933, the banking firm of Rush, Bowen & Company, which had directed and participated in the original distribution of the maturing debenture issue, conferred with the company's executives in order to work out a feasible extension plan for the various creditor groups. It was agreed that the claims of merchandise creditors would not be treated on the same basis as those of the banks and debenture holders.

The liquidator of the Montrose State Bank, which had extended a line of credit and at the time held $462,000 of Welland unsecured notes, emphatically stated that he considered his first obligation was to depositors of the closed bank. When he learned that tentative plans proposed first mortgage security for new notes to be exchanged for maturing debentures, he promptly insisted that the company should protect the bank's position by pledge of its accounts receivable. The Welland management agreed to this, and the bank began at once to select the choice accounts. Realizing that such a race for security could end only in delay and confusion, Rush, Bowen & Company urged upon the company the necessity of equal treatment for the banks and debenture holders. Careful analysis of financial data was presented to show that the Welland Machinery Company was clearly worth saving, and that independent legal action by any of the unsecured creditors might wreck a promising concern to the advantage of no single group of creditors.

The Welland Machinery Company offered extensive statistical evidence of its relative strength in the industry.[1] It submitted a report which outlined in great detail the financial status of the company as of March 31, 1933. Because of unusual conditions in March, sales of new machines for the first quarter were only one-third of the expected volume. Budgetary estimates were drastically lowered for April with fixed charges reduced by 33%. The revised budget adjusted the salary scale to 30 to 50% of that prevailing in 1930, with executive salaries based on a sliding scale according to profits realized.

The report gave considerable attention to the capital needs of the company imposed by the liberal credit terms available to customers. It was noted that 70% of the sales of the preceding two years were credit sales on 15-month terms. During the depression, renewals of customers' notes had extended these terms to 18 or 19 months, so that the total amount of credit extended on each sale was outstanding, on the average, for a period of about 9 months. With average sales of $100,000 a month, total credit to customers would be stabilized at around $700,000; with sales at the 1932 level of $2,400,000 a year, around $1,300,000. Therefore, until the company could get permanent capital of around $1,300,000 by stock or debentures, it would have to obtain that amount through bank loans or other short-term credit. Although contingent liabilities with finance companies amounted

[1] Using data reported by 22 companies producing 90% of the volume in the industry, the Welland Machinery Company showed that its performance was better than that of the industry as a whole during depression years. All figures in the first four columns are percentages of gross sales.

Year	Name	Cost of sales (per cent)	Gross profit (per cent)	Operating profit (per cent)	Net profit (per cent)	Operations to capacity (per cent)
1930	Welland Co.	73.1	26.9	5.1	3.6	80.2
	Industry	72.7	27.3	3 9	3.1	64.1
1931	Welland Co.	72.0	28.1	5.1	3.3	61.7
	Industry	77.4	22.6	2.8[d]	3.8[d]	43.0
1932	Welland Co.	79.0	21.1	10.1[d]	12.5[d]	25.7
	Industry	95.2	4.8	34.6[d]	35.8[d]	17.3
1933*	Welland Co.	82.6	17.4	17.1[d]	19.3[d]	13.3
	Industry	95.1	4.9	32.6[d]	32.6[d]	12.5

* Six months.
[d] Deficit.

to about $325,000 on March 31, no cash outlay on this account was anticipated since the attitude of the finance companies had been to accept substitute notes for any which had to be taken up.

The report concluded by pointing out that from 1929 to 1931 the net sales averaged $6,900,000 a year, of which approximately $5,600,000 was spent within the state on wages, salaries, and materials. Since nearly 90% of the sales were to customers in other states, the funds so spent for pay roll and materials were all contributed from outside sources. It was emphasized in discussions with the liquidators of the banks that the net result of the circulation of these funds within the state was to create a volume of exchange several times the total sales indicated.

For the remainder of 1933 the management proposed to operate on a basis whereby collections from receivables, together with proceeds from available discounts of deferred payment notes from sales thereafter consummated, would cover all necessary cash outlay for operations, including interest on debentures. It also was proposed to apply all collections from outstanding notes receivable, all proceeds from sale of repossessed machines then in inventory, and all payments on outstanding notes discounted to the reduction of existing obligations to banks and finance companies.

This evidence of careful budgetary control by the management of the Welland Machinery Company and its quick adjustment to adverse operating conditions confirmed the opinion of Rush, Bowen & Company that creditors should join without delay in some plan for deferring their claims so that the company would be free to give full attention to its operating problems. Representatives of the banks met in conference with those for the debenture holders and those for the company and agreed that all would be best served by the prompt adoption of an extension plan which would give preference to no one and which would not hamper the company by placing restrictions on its working capital. With this basis for negotiation finally accepted, a plan for the extension of the company's debts, other than to merchandise creditors, was drawn up by Rush, Bowen & Company and accepted by the bank creditors. The principal provisions follow:

1. A reduction in the board of directors from eight to five members, with the majority of the nominees satisfactory to the representatives of the creditors. The board's term was to be extended to three years.

2. An executive committee of three to be set up within the board.

3. The execution of an indenture which would provide for the issue by the company of 6½% refunding notes of an aggregate principal of approximately $1,100,000 to cover maturing debentures and the bank loans, which could be called in whole, but not in part, for payment on the first day of any month upon 30 days' prior notice, at 101 and accrued interest. The principal of the notes would be payable in quarterly installments beginning on April 1, 1934, on a schedule of payments that would leave approximately 50% of the principal amount of the notes due and payable on July 1, 1936.

4. The company not to place a mortgage or other lien upon its plant or fixed assets, nor pledge its inventory with any creditor, except with prior written consent of the holders of not less than 75% in principal amount of the notes then outstanding.

5. The company to maintain a ratio between quick assets[1] and current liabilities[2] of not less than 200% and to maintain net quick assets of not less than $325,000, the new notes not to be counted as current liabilities.

6. The company not to pay dividends on either its common stock or preferred stock until such notes were paid in full.

It was further agreed that the company would pay all expenses incident to the consummation of the plan and that the plan might be declared effective by the company at any time after 75% of the 6½% debentures had been deposited, with privilege of extension of the time allowed for deposit by creditors for 30-day periods, but not beyond October 1, 1933.

Added protection was given to the refunding issue by a provision in the indenture that the 10-year 6½% debentures of the company which were deposited with the trustee must be held by him in uncancelled form, without impairment of lien or security, as a part of the security for the new issue of refunding notes.

On June 22, 1933, the Welland Machinery Company sent letters to the holders of the 10-year 6½s informing them of its inability to pay in cash the principal amount but that its intention was to pay the final interest coupons. The letter further emphasized that it would be to the advantage of the debenture holders to cooperate with the company in a plan which would enable the company to pay its debts and to continue its position among the leaders of the industry. At the same time Rush, Bowen & Company sent an advisory letter to the debenture holders giving a full

[1] Quick assets were to include cash and unrestricted funds in banks, securities of the United States Government at market prices, and unpledged receivables arising in the ordinary course of business after deduction for doubtful items. Advances to subsidiary companies were to be excluded.

[2] Current liabilities were not to include contingent liabilities on endorsed paper until default by the principal obligor.

analysis of the plan and a recommendation for its prompt acceptance. The letter further stated that the Welland Machinery Company had agreed upon a retaining fee to the bankers of ½ of 1% of the principal amount of the outstanding issue, and further payment of 1½% of the principal amount of deposited debentures.

1. Study the plan proposed for the relief of the Welland Machinery Company with reference to (*a*) its effectiveness in meeting the financial needs of the company, and (*b*) its probable success in obtaining favorable action by the creditors.

2. Account for the essential differences between this plan and the one prepared for the Buell Products Company.

3. What points should be emphasized by the bankers in their appeal to the debenture holders for deposits under the plan?

EXHIBIT 1
WELLAND MACHINERY COMPANY
BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1929	1930	1931	1932	March 31, 1933
ASSETS					
Current Assets:					
Cash	$ 27	$ 30	$ 165	$ 109	$ 87
Accounts and Notes Receivable, Less Allowance for Doubtful Accounts	1,475	1,371	1,558	1,308	1,250
Inventory	2,137	1,625	1,660	1,401	1,451
Total Current Assets	$3,639	$3,026	$3,383	$2,818	$2,788
Investment in Affiliated Companies	722	730	730	730	738
Restricted Deposits and Other Assets	41	54	52	57	
Permanent Assets, Less Allowance for Depreciation	1,653	1,717	1,690	1,664	1,860
Patterns, Patents, etc. (Book Value)	183	204	229	210	
Prepaid Expenses and Deferred Charges	124	75	58	54	68
Total Assets	$6,362	$5,806	$6,142	$5,533	$5,454
LIABILITIES					
Current Liabilities:					
Notes Payable	$ 943	$ 520	$ 845	$ 806	$ 806
Accounts Payable	525	327	389	232	145
Accrued Taxes and Interest	91	63	32	14	35
Total Current Liabilities	$1,559	$ 910	$1,266	$1,052	$ 986
Bonds Payable:					
10-year 6½% Debentures Due July 1, 1933	585	546	502	463	463
Reserves	....	......	......	......	162
Capital Stock:					
Preferred, 7% Cumulative	1,163	1,138	1,138	1,123	1,123
Common Stock and Surplus	3,055	3,212	3,236	2,895	2,720
Total Liabilities	$6,362	$5,806	$6,142	$5,533	$5,454

EXHIBIT 2
WELLAND MACHINERY COMPANY
OPERATING STATEMENT, YEARS ENDED DECEMBER 31
(In thousands of dollars)

Item	1929	1930	1931	1932
Sales	$ 7,920	$ 6,999	$ 5,738	$ 2,416
Cost of sales	5,704	5,079	4,087	1,862
Gross profit	$ 2,216	$ 1,920	$ 1,651	$ 554
Sales and administrative expenses:				
Erection and service	153	143	129	64
Shipping	112	108	64	33
Selling	978	1,004	868	486
Administrative and general	245	254	232	165
Operating profit (before depreciation)	$ 728	$ 411	$ 358	$ 194[d]
Interest and discount, less interest and finance fees earned	76	80	59	61
Other deductions	30	25	49	16
Other income (dividends from subsidiaries)	58	49	49	7
Other deductions (net)	$ 48	$ 56	$ 59	$ 70
Net profit before depreciation and amortization	680	355	299	264[d]
Depreciation and amortization	91	94	73	47
Federal tax	59	26	23	
Net profit	$ 530	$ 235	$ 203	$ 311[d]
Dividends:				
Preferred stock	$ 71,692	$80,776	$79,694	$19,752
Common stock	150,628	43,758	98,788	

[d] Deficit.

10. HARPER MANUFACTURING COMPANY

PLAN OF READJUSTMENT FOR DEFAULTED BONDS

Early in 1934 it appeared that the efforts of the Harper Manufacturing Company to avoid serious financial readjustment had failed. Interest was defaulted December 1, 1933, on the 7% first mortgage gold bonds due in 1939. Unpaid taxes had accrued since the last half of 1932. Mr. Stanton, the new president, had taken office in November, 1933, through the support of an active minority of stockholders who were convinced that quick action must be taken to save their company. The president was hopeful that the urgent need for current financing could be met through local banks or loans by a governmental agency.

The Harper Manufacturing Company, organized in 1868, still held its place as one of the six largest producers of fire escapes as well as of a varied line of ornamental iron products. After 1925 some attempt was made to enter the automobile accessory field, but by 1930 this part of the business had dwindled to insignificant proportions because of the underbidding of more efficient competitors. The company also had discontinued production of a new line of coal and wood stoves and ranges, which it had undertaken in 1926. From the start the added line was a doubtful venture, but not until the loss had exceeded a million dollars was the project abandoned. Certain factors, however, were favorable to successful operation should the immediate financial problems be solved. Situated in a densely populated area on the eastern seaboard, the company had a distinct advantage in freight rates. It also had more modern equipment than most of its competitors, and with efficient management it could have the lowest costs in the field.

By 1930 fire escapes made up nearly 60% of the company's dollar volume of sales. Sales volume of fire escapes showed the following fluctuations since 1925: 1925, $1,167,638; 1926, $1,920,771; 1927, $867,763; 1928, $810,246; 1929, $1,575,405; 1930, $927,890; 1931, $1,786,029; 1932, $124,072. Net profits after all charges were 1925, $202,720; 1926, $44,517; 1927, $829,689 (deficit); 1928, $416,838 (deficit); 1929, $102,423; 1930, $139,964. A balance sheet as of April 30, 1934, and an operating statement for the years ended December 31, 1931, 1932, and 1933, and for

the four months ended April 30, 1934, are shown in Exhibits 1 and 2.

After the large operating loss of the company in 1927, its three creditor banks, which had been extending large credit lines during the developmental period for the new products, had loans outstanding of a million dollars and no immediate prospect of payment. They demanded that reduction of loans be undertaken at once and insisted upon control of the management until payment was completed. Mr. Gaylord, the banks' appointee as president, in the five years to 1933 had paid off all the bank loans and reduced the bonded debt to $266,000. Convinced that the company was fast approaching complete liquidation as the result of such a rigorous attack on debts, stockholders united to remove Mr. Gaylord and to elect a board committed to an aggressive policy that would restore the business to profitable operation. Accordingly, in October, 1933, Mr. Stanton, for 30 years sales manager of the company, was made president. Of the other five members of the board of directors, only one had had the kind of experience that would make him a competent critic of financial policy.

In the interest of clients, Weld & Company, the underwriters and one of the distributors of the $1,800,000 first mortgage bonds of the Harper Manufacturing Company issued in 1924, conferred with the company's officers about its financial position. Mr. Stanton recognized the need for more working capital but hoped that some arrangement could be made through the Reconstruction Finance Corporation to ease the company's current position. The management was unwilling at that time to do anything about recasting the capital structure. If funds could be secured the defaulted interest would be paid. The president also announced a policy of taking new business only if it carried a profit. Overhead had been reduced by $3,000 a month. Although the closing of the company's depositary banks had reduced available cash by $55,000 and the labor provisions of the N.R.A. had so raised costs that losses were being incurred on contracts figured at previous costs, the company had prospects of some profitable business if it could procure temporary funds. The company expected that if it could so increase its working capital it would be the successful bidder on two contracts amounting to $430,000 which would yield a substantial net profit.

Because of defaults in dividends, holders of the preferred stock became entitled to elect a majority of the board of directors at

the January, 1934, meeting of stockholders. With continued default in bond interest, Weld & Company talked further with the company's officers and was told that a New York firm, previously in the brokerage business, had already made a thorough study of the company's position and had proposed a plan for refinancing which, although details were not all disclosed, would extend the maturity of the bonds and make the interest a contingent charge. It was further planned to eliminate the preferred stock and to divide a new issue of common stock so that it would give the existing preferred stockholders immediate control but provide for a yearly distribution of common stock to the bondholders in case the full 7% interest could not be paid in cash.

It also was revealed that the cost to the Harper Manufacturing Company of this refinancing plan would be 4% of the principal amount of the outstanding bonds and 2% of the preferred stock. The New York firm had engaged the necessary legal and auditing services on a contingent basis and had further agreed to defer the final payment of the fee until the Harper Manufacturing Company should reestablish a strong cash position.

With but one dissenting vote, the board of directors in April adopted the plan as outlined by the New York firm. Weld & Company informed Mr. Stanton of its dissatisfaction with the plan which, at the cost of an inordinate fee, was wholly inadequate in view of the company's immediate financial problems. Although it would give all possible assistance to the company in exploring possible sources for the much needed working capital, its responsibility as an underwriter of the original bonds would require that it advise bondholders against acceptance of the plan.

None of the three banks of the city was willing to furnish the company any part of the funds necessary for undertaking the two large contracts. Inquiry also was made of a mortgage loan company[1] which had been organized in the city to act as an intermediary between the R.F.C. and applicants for industrial loans. Meanwhile the New York firm had given some thought to the working capital problem of the company and reported a prospective arrangement whereby a New York bank would advance enough funds to a large steel company on the basis of

[1] Such a company acted only as adviser and consultant to insure full presentation of the merits of the application. The loans had to be adequately secured, ordinarily by mortgage on plant property. The borrower had to submit evidence of his ability to liquidate the loan within the loan period out of profits or through sale of assets.

accounts receivable from the Harper Manufacturing Company, and thereby would finance the materials necessary to fulfill the new contracts.

Under the leadership of a bondholder who owned or controlled \$25,000 of Harper Manufacturing Company bonds, an informal bondholders' protective committee was formed in July. In order to avoid registration under the Securities Act of 1933, deposits of bonds were not solicited; bondholders were merely asked to sign a statement appointing the committee as its agent in investigating the affairs of the Harper Manufacturing Company. There was also an express reservation to the effect that the committee could take no action affecting the rights of the bondholders without written approval by the bondholders.

Shortly after the formation of this committee, the Harper Manufacturing Company sent a letter to the bondholders advising them that it was in the process of registering the plan of readjustment under the Securities Act and would presently supply all security holders with a comprehensive summary of the company's affairs. In view of the known objections of a substantial minority, and since no definitive plan had yet been laid before them, the company urged their full cooperation in delaying any action until the detailed plan was published.

Within the month, registration had been completed with the Federal Trade Commission and a prospectus issued presenting the plan of readjustment in full detail, as well as a comprehensive survey of the company's financial position. Details of the contract with the New York firm also were given. The essentials of the proposed plan were as follows:

Authorization of 150,000 no-par common shares, such number not to be increased before January 1, 1939, unless all bonds should first be retired. Of these 150,000 shares, 15,000 to be exchanged for the 87,432 outstanding common shares, and 50,000 for the 6,630 outstanding preferred shares. Exchange of outstanding bonds for 10-year 7% cumulative income bonds with mortgage security unchanged and interest payable out of net earnings before depreciation. If such earnings for any of the 5 years beginning January 1, 1934, should be nil, the bondholders to receive, in full satisfaction of their interest claim for such year, 15,000 common shares provided all the \$266,000 of bonds are then outstanding, and in the same ratio for any smaller amount outstanding. A proportionately smaller number of common shares to be issued in lieu of unpaid interest if earnings for any of the 5 years provide payment of a part only of the 7% annual interest. Thus, if earnings should provide only 3½% interest for any year, and \$199,500 bonds were outstanding, bondholders would receive 5,625 shares.

The company then asked for deposits under the plan. Under the deposit agreement the plan could become operative only after two-thirds of the shareholders of each class had voted in favor of the reclassification of stock, and 75% of the outstanding bonds had been deposited within six months after the prospectus was mailed.

1. Outline the points that the Harper Manufacturing Company should have emphasized in a letter soliciting deposits of bonds under the plan.

2. What reasons could Weld & Company have given its clients for standing with the minority committee against acceptance of the plan?

3. In what ways did the Securities Act of 1933 modify the procedure in working out a financial readjustment for the Harper Manufacturing Company?

4. Is this a case where petition under Sec. 77*B* of the amended Federal Bankruptcy Act would be best for the company and for its creditors?

EXHIBIT 1
HARPER MANUFACTURING COMPANY
BALANCE SHEET, AS OF APRIL 30, 1934

ASSETS	
Cash	$ 11,540
Notes and Accounts Receivable, Less Reserve	118,255
Inventories	83,463
Restricted Funds in Closed Banks, Less Reserve for Possible Losses	22,400
Fixed Assets, Less Reserve for Depreciation and Obsolescence ($1,639,478)	945,438
Deferred Charges	27,363
Deficit	311,815
Total Assets	$1,520,274
LIABILITIES	
Accounts Payable	$ 74,400
Bond Interest Payable and Accrued	18,620
Accrued Taxes—Due and Past Due	50,662
Other Accruals	5,932
Funded Debt	266,000
Reserve for Contingencies	4,500
Capital Stock:	
Preferred, Par Value $100	663,000
Common, No-par Value*	437,160
Total Liabilities	$1,520,274

* Stated value, $5 a share.

EXHIBIT 2
HARPER MANUFACTURING COMPANY
OPERATING STATEMENT, YEARS ENDED DECEMBER 31

Item	1931	1932	1933	4 months ended April 30, 1934
Sales, less returns and allowances	$1,897,110	$985,493	$228,377	$128,847
Cost of sales	1,555,421	886,139	274,253	105,425
Gross profit	$ 341,689	$ 99,354	$ 45,876[d]	$ 23,422
Expenses:				
Taxes	36,776	26,454	22,702	6,218
Depreciation	87,792	83,212	37,802	11,028
Other expenses	198,804	134,763	74,381	24,980
Total expenses	$ 323,372	$244,429	$134,885	$ 42,226
Net income	18,317	145,075[d]	180,761[d]	18,804[d]
Other income:				
Net income from leased property*	1,643	8,637[d]	8,747[d]	5,042[d]
Profit from sale of capital assets	6,772[d]	858	1,180	166[d]
Other income	4,337	3,001	1,240	
Other deductions	46,536	29,339	23,381	7,658
Extraordinary deductions	......	......	43,050	
Net income before income taxes	$ 29,011[d]	$179,192[d]	$253,519[d]	$ 31,670[d]

* For 1933, the gross rental was $20,300; for the first four months of 1934, $11,855.
[d] Deficit.

VI

SPECIAL ADMINISTRATIVE PROBLEMS

1. DE FOREST MOTOR CAR COMPANY

FORMULATION OF PLAN FOR REMOVING FINANCIAL DIFFICULTIES WITHOUT RECOURSE TO REORGANIZATION

Incorporated in Michigan in 1909 with a modest capital of $5,000, the De Forest Motor Car Company emerged successfully from its early stages of development and by 1925 had become an important producer of automobiles in the medium-price field. In the latter year approximately 40,000 De Forest cars were manufactured in the company's thoroughly modern plant which provided capacity for producing 500 units per day.

From the origin of the company up to 1925, physical expansion had been financed largely out of earnings. Although new capital to the extent of $4,000,000 had been secured by the sale of preferred and common stock, the company had reinvested over $5,000,000 of its profits. During this same period another $5,000,000 had been paid out in dividends to owners of the preferred and common stocks.

Despite the company's past conservative financial policy and its adequate production facilities, its competitive position in the industry declined rapidly during 1926. Profits fell off greatly, and prospects for 1927 indicated a large deficit. In the spring of 1927 the stockholders approved a drastic reorganization in the company's affairs.

The directors of the company accepted the resignation of the president and induced Mr. Gilbert Watson, a successful automobile executive, to invest a considerable sum of money in the business and to take over the management for a five-year period. The essential provisions of the agreement with Mr. Watson were as follows:

1. Mr. Watson was to receive a compensation of 5% of the annual net earnings if from $1,000,000 to $2,000,000, or 10% if in excess of $2,000,000.

2. An issue of 40,000 shares of 7% Cumulative Convertible Second Preferred Stock, par value $100, was created. Mr. Watson was given the right to subscribe to all this stock at 90, with the exception of 3,273 shares taken by stockholders who refused to waive their rights. This stock carried voting privilege of 10 votes per share.

3. An irrevocable option was issued to Mr. Watson to purchase all or any part of 400,000 shares (less subscription rights not waived by other stockholders) of common stock at the price of $10 per share.

4. A five-year voting trust was established. All stockholders had the right to deposit their stock with this voting trust, but enough was secured in advance to give control to Mr. Watson who took over, in addition to the new second preferred stock, the large interests of the former president of the company.[1]

Under Mr. Watson's management the company acquired large amounts of new capital. Soon after the sale of over $3,000,000 of the second preferred stock, an additional $3,000,000 was received by the sale of 300,000 shares of common at $10 per share. According to the terms of the privileged subscription, each holder of 1 share of common had the right to subscribe to 0.266 of a share, and each holder of 1 share of second preferred stock had the right to subscribe to 2.66 shares of the new issue. Mr. Watson, in addition to purchasing all the new stock to which his holdings entitled him, subsequently in May, 1928, exercised his option and purchased 374,377 shares of common at $10 per share. By this time De Forest common stock had risen from a low of less than $8 in 1927 to $38 per share. Still further capital was raised in September, 1928, by the sale of $3,000,000 of 6% debentures due in August, 1933, and $500,000 of 6% serial gold notes which matured in August, 1931, 1932, and 1933.

This program of capital expansion was completed in April, 1929, when the company offered another privileged subscription by which it secured from its stockholders approximately $7,000,000 through the sale of 283,758 shares of common stock at $25 per share.

Under the stimulus of the new management, fresh capital, and a satisfactory public demand for its cars, output of De Forest cars was increased from 22,000 in 1927 to 73,000 in 1928, and earnings of over $1,000,000 available for preferred and common dividends were reported. Within the same period the number of employees was increased from 1,800 to 6,100 and the common stock of the company rose to a high of 61¼ in September, 1928.

[1] This voting trust was terminated on May 1, 1931.

With earnings of over $500,000 shown for the first quarter of 1929, fixed charges were earned nine times and fixed charges plus preferred dividends were earned nearly four times.

Profitable operation under the new management was, however, of short duration. In common with other units in the industry, the company experienced a severe reduction in sales during 1930 and 1931. The number of De Forest cars produced declined to 20,000 in 1931, and the profits of 1928 were replaced by heavy losses. The effect of mounting deficits upon the financial position of the company is indicated in Exhibits 1, 2, and 3. As a result of these drastic changes in the condition of the De Forest Motor Car Company, the directors were confronted with financial problems of major importance and in July, 1932, were attempting to formulate plans for improving the financial status of the company.

1. What were the financial problems of the company in July, 1932?

2. Present a practical plan for meeting these problems and show by a pro forma balance sheet how the financial position of the company could have been improved by its adoption.

EXHIBIT I
DE FOREST MOTOR CAR COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1926	1927	1928	1929	1930	1931	June 30, 1932
ASSETS							
Cash and Securities	$ 543,428	$ 2,337,554	$ 3,022,284	$ 6,180,300	$ 2,995,165	$ 1,482,403	$ 1,042,264
Receivables	1,105,541	1,831,156	1,295,915	1,030,978	734,269	609,228	477,470
Inventories	5,463,491	3,809,175	8,306,519	7,343,006	5,429,687	2,555,010	2,620,009
Total Current Assets	$ 7,112 460	$ 7,977,885	$12,624,718	$14,554,284	$ 9,159,121	$ 4,646,641	$ 4,139,743
Advances and Deferred Assets	561,520	851,219	1,399,795	1,533,821	1,612,606	1,058,744	629,684
Plant and Equipment (Appraised Value)	5,680,898	7,879,560	13,747,533	14,058,463	12,962,747	11,883,481	11,422,545
Preferred Stock Purchased for Redemption	63,750	29,297	72,695	110,095			
Common Stock Subscriptions	...	....	404,670				
Total Assets	$13,418,628	$16,737,961	$28,249,411	$30,256,663	$23,734,474	$17,588,866	$16,191,972
LIABILITIES							
Current Liabilities	$ 3,206,686	$ 3,475,637	$ 6,266,413	$ 3,455,534	$ 3,032,080	$ 2,619,068*	$ 1,844,676*
6% Sinking Fund Gold Debentures, A, 1933	....	....	2,750,000	2,400,000	1,950,000	1,500,000	1,250,000
6% Serial Gold Notes	....	....	450,000	400,000	350,000	300,000	300,000
Land Contract	....	....	591,000	325,000	275,000	225,000	225,000
Minority Stockholders' Equity	....	93,351	429,181	527,410	262,086	40,245	30,046
Employees' Payments on Stock Subscriptions	....	....	....	13,150	12,149	10,235	
Reserve for Dividends on Second Preferred Stock	....	65,597	312,926	561,535	808,467	1,027,476	1,104,502
7% Cumulative Preferred Stock	1,948,000	1,900,600	1,900,600	1,802,700	1,631,200	1,544,700	1,487,900
7% Cumulative Convertible Second Preferred Stock	....	3,748,400	3,576,300	3,565,300	3,553,700	3,453,700	3,243,500
Common Stock Equity	8,263,942	7,454,376	11,972,991	17,206,034	11,859,792	6,868,442	6,706,348
Total Liabilities	$13,418,628	$16,737,961	$28,249,411	$30,256,663	$23,734,474	$17,588,866	$16,191,972

* Includes $50,000 6% Serial Gold Notes, due August 15, 1932.

EXHIBIT 3
DE FOREST MOTOR CAR COMPANY
PROFIT AND LOSS ACCOUNT AND DISPOSITION OF EARNINGS, YEARS ENDED DECEMBER 31

Item	1925	1926	1927	1928	1929	1930	1931	6 mos. Jan.–June, 1932
Sales	$62,763,787	$36,833,471	$23,957,702	$61,464,397	$64,489,904	$27,777,482	$16,499,298	$ 7,655,094
Less: Cost of sales	55,208,061	32,315,505	21,929,742	55,308,381	59,035,293	27,185,452	16,718,149	6,488,180
Gross profit	$ 7,555,726	$ 4,517,966	$ 2,027,960	$ 6,156,016	$ 5,454,611	$ 592,030	$ 218,851[d]	$1,166,914
Miscellaneous income	....	24,014						
Total manufacturing profit	$ 7,555,726	$ 4,541,980	$ 2,027,960	$ 6,156,016	$ 5,454,611	$ 592,030	$ 218,851[d]	$1,166,914
Less: Selling and administrative expenses	4,705,853	3,674,006	3,095,026	4,097,743	4,597,151	2,949,361	1,816,302	734,925
Net profit from operations	$2,849,873	$ 867,974	$ 1,067,066[d]	$ 2,058,273	$ 857,460	$ 2,357,331[d]	$ 2,035,153[d]	$ 431,989
Less: Miscellaneous charges	67,007	177,447	93,816	44,205	259,840	494,163	666,936	176,590
Net profit before depreciation	$ 2,782,866	$ 690,527	$ 1,160,882[d]	$ 2,014,068	$ 597,620	$ 2,851,494[d]	$ 2,702,089[d]	$ 255,399
Less: Depreciation*	....	....	....	573,981	932,104	762,160	762,566	356,658
Net income before Federal income tax	$ 2,782,866	$ 690,527	$ 1,160,882[d]	$ 1,440,087	$ 334,484[d]	$ 3,613,654[d]	$ 3,464,655[d]	$ 101,259[d]
Less: Provision for Federal income tax	345,000	61,000						
Net income	$ 2,437,866	$ 629,527	$ 1,160,882[d]	$ 1,440,087	$ 334,484[d]	$ 3,613,654[d]	$ 3,464,655[d]	$ 101,259[d]
Less: Subsidiary company's losses	....	129,320	820,060	384,408	1,129,103	1,355,666	1,271,271	148,538
Net income available for dividends	$ 2,437,866	$ 500,207	$ 1,980,942[d]	$ 1,055,679	$ 1,463,587[d]	$ 4,969,320[d]	$ 4,735,926[d]	$ 249,797[d]
Less: Preferred dividends†	153,014	131,207	280,227	377,424	372,004	361,849	328,750	77,926
Earned on common stock	$ 2,284,852	$ 369,000	$ 2,261,169[d]	$ 678,255	$ 1,835,591[d]	$ 5,331,169[d]	$ 5,064,676[d]	$ 327,723[d]
Less: Dividends on common stock—cash	905,357	913,009						
Less: Dividends on common stock—stock	764,740							
Balance to surplus	$ 614,755	$ 544,009[d]	$ 2,261,169[d]	$ 678,255	$ 1,835,591[d]	$ 5,331,169[d]	$ 5,064,676[d]	$ 327,723[d]
Common shares outstanding Dec. 31	676,474	676,474	1,050,756	1,442,343	1,727,201	1,728,361	1,738,361	1,758,861
Earned per share of common	$3.39	$.54	....	$.47				

* Included in cost of sales before 1928.

† This includes dividends declared and paid on 7 % cumulative preferred stock, and a reserve for dividends on 7 % cumulative convertible second preferred stock, of which only one quarterly dividend was actually declared and paid.

[d] Deficit.

Exhibit 4
De Forest Motor Car Company
Securities Outstanding in July, 1932

6% *Sinking Fund Gold Debentures.*
Dated August 1, 1928; due August 1, 1933.
Original issue, $3,000,000; outstanding, $1,250,000.
Not secured by a mortgage, but the company covenants to create no mortgage or other indebtedness prior to or of same rank with these debentures, except short-term obligations.

6% *Serial Gold Bonds.*
Dated August 15, 1928; due (outstanding portion) August 15, 1933.
Original issue, $500,000; outstanding, $300,000.

7% *Cumulative Preferred Stock*, par value $100.
Authorized, $3,000,000; outstanding, $1,487,900.
First preference as to assets and dividends.
Callable at 105 for sinking fund made up of 10% of net profits after preferred dividends.
Redeemable at par in 1939.
No voting power, except when capital is impaired or dividends passed.

7% *Cumulative Convertible Second Preferred Stock,* par value $100.
Authorized, $4,000,000; outstanding, $3,243,500.
Second preference as to assets and dividends.
Convertible at any time on or before July 1, 1932, at rate of 10 shares of common stock for 1 share.*
Redeemable before July 1, 1932, only by consent of holders of majority of issue outstanding. Redeemable in whole or in part at 105 and dividends after July 1, 1932, at option of corporation. Redeemable in full at par and dividends in 1939.
Voting power: 10 votes per share.

Common Stock, no par value.
Authorized, 2,500,000 shares; outstanding, 1,758,861 shares.
Voting power: 1 vote per share.

* The stockholders on April 18, 1932, authorized the directors to increase the conversion rate to 16 shares of common, but such increase was not actually made before July 1, 1932.

Exhibit 5
De Forest Motor Car Company
Price Range of Common Stock

Date	Low	High
1925	17⅜	33
1926	9	28¼
1927:		
1st quarter	7⅞	11⅞
2d quarter	8	14½
3d quarter	10¼	13
4th quarter	9⅛	18¾
1928:		
1st quarter	16¾	27⅞
2d quarter	23	39⅞
3d quarter	30	61¼
4th quarter	40⅝	60¼
1929	7⅜	54
1930	3	13⅜
1931	1⅞	6½
1932:		
1st quarter	2	4⅝
2d quarter	1	2⅛

2. FAIRFIELD MANUFACTURING COMPANY (II)[1]

USE OF FINANCIAL BUDGET

Early in 1934 the treasurer of the Fairfield Manufacturing Company realized that unusually large seasonal borrowings would be necessary during the course of the year. In view of the business conditions prevailing in 1932 and 1933, the company had reduced its working capital and had used its funds for the purchase of its own preferred stock. With improving business and rising prices, which appeared probable in 1934, seasonal working capital requirements would be greatly increased. Under these conditions the treasurer of the company wished to obtain assurance well in advance that ample funds would be available when needed. He therefore asked the banks with which the company had done business for many years to grant lines of credit aggregating $1,000,000. Although the bankers understood the circumstances surrounding the purchases of the preferred stock and the company's possible need for funds, they had not anticipated that so large a line of credit would be requested.

Since 1930 when the peak debt, consisting partly of commercial paper, had been $500,000, the company had not borrowed to any considerable extent. During 1931 and 1932, moreover, the company had been entirely free from bank debt and in 1933 had borrowed at the most only $200,000, holding at the same time more than $200,000 in government securities. Upon examining the balance sheets and operating statements (see Exhibits 1 and 2), the bankers offered to grant credit lines, totaling $400,000, but stated that they could see no justification for a line of the size requested.

The treasurer believed, nevertheless, that this refusal was not the result of a lack of confidence in the company but merely of a failure fully to understand the special nature and problems of the business. Accordingly he decided to work out in detail a financial budget, which would indicate the company's month-by-month need for funds as well as the times at which a seasonal clean-up of outstanding loans could be effected. The budget, he thought, would be of value in convincing the bankers not only of the company's need for extensive loans at certain seasons of the year,

[1] Refer to Fairfield Manufacturing Company (I), Sec. IV, for an account of purchases of preferred stock, as well as for pertinent information concerning the company's business.

but also of the readiness with which these loans could be liquidated when the annual peak of the company's business was past.

Subsequently he submitted to the officers of the bank a budget based on annual sales of 75,000 dozen quilts. This budget, in the form of a chart, indicated the amounts of cash and securities the company might expect to have on hand at the end of each month for two levels of raw-material prices. From the chart could be determined the sums which must be borrowed to maintain a cash balance of $50,000, a minimum requisite, in the opinion of the treasurer.

The process of drawing up the budget involved, in the first place, ascertaining the approximate amounts of cash and securities which the company would have in the beginning of the year at each of the two price levels. These amounts were then modified month by month by carrying through hypothetical transactions, estimated partly on the basis of sales and manufacturing budgets and partly from past experience.

The treasurer stated that four variables affected the amounts of cash and securities on hand. They were as follows:

1. The physical volume of sales.
2. The prices of raw materials (see Exhibit 4).
3. The promptness with which the company's customers paid their bills.
4. Shifts of department-store buyers from one price line to another.

The budget plan adopted made allowance for the first of these variables by employing a sales figure somewhat in excess of probable sales. Allowance for the second variable was made by the use of two budget lines based upon two levels of raw-material prices. The final two variables were much less important and less likely suddenly to undergo extreme changes.

In addition to the financial budget the treasurer gave the bankers the supplementary information, as shown in Exhibit 5, explaining that the figures for the year 1933 were not altogether typical because of the effect of Red Cross orders filled early in the year. He also informed the bankers that, by observing on the chart the company's actual cash and securities position, he would be able to notify the banks several months in advance of his need for funds.

1. What are the advantages and limitations in the use of a financial budget?

2. Should the banks, after examination of the treasurer's budget, have granted the requested increase in the Fairfield Manufacturing Company's credit lines?

EXHIBIT 1
FAIRFIELD MANUFACTURING COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932	1933
ASSETS					
Cash	$ 320,230	$ 315,543	$ 433,345	$ 458,562	$ 145,837
U. S. Government Securities	98,681	....	496,872	229,894	202,375
Accounts Receivable, Less Reserves	422,151	304,914	189,388	128,984	144,626
Inventories—Lower of Cost or Market	1,481,252	1,120,321	390,691	289,407	606,198
Total Current Assets	$2,322,314	$1,740,778	$1,510,296	$1,106,847	$1,099,036
Investments and Miscellaneous Assets	52,312	42,280	47,027	57,264	57,096
Land, Buildings, and Machinery, Less Depreciation	1,069,343	1,040,576	943,028	869,535	837,531
Deferred Charges	13,736	14,591	10,414	8,385	8,118
Total Assets	$3,457,705	$2,838,225	$2,510,765	$2,042,031	$2,001,781
LIABILITIES					
Accounts Payable	69,953	35,197	11,085	13,697	8,271
Accrued Accounts	16,538	13,195	25,779	23,927	27,944
Reserve for Income Taxes	34,063				
Total Current Liabilities	$ 120,554	$ 48,392	$ 36,864	$ 37,624	$ 36,215
$4 Cumulative Convertible Preferred Stock, $60 Par Value	2,100,000	2,040,000	2,040,000	1,062,000	975,660
Common Stock, No Par	400,000	400,000	400,000	420,000	424,180
Capital Surplus	....	......	....	665,986	735,381
Earned Surplus	837,151	349,833	33,901	143,579[d]	169,655[d]
Total Liabilities	$3,457,705	$2,838,225	$2,510,765	$2,042,031	$2,001,781

[d] Deficit.

EXHIBIT 2
FAIRFIELD MANUFACTURING COMPANY
INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932	1933
Gross profit from operations	$506,856	$ 57,408	$ 12,189	$ 73,957	$227,740
Other income	37,854	....	....	10,295	5,849
Total	$544,710	$ 57,408	$ 12,189	$ 84,252	$233,589
General, administrative, and selling expenses	260,200	322,141	225,497	195,275	185,781
Depreciation	....	78,842	79,603	66,457	61,578
Federal income taxes	30,153				
Miscellaneous charges	30,614	14,262	5,796		
Total	$320,967	$415,245	$310,896	$261,732	$247,359
Net profit	$223,743	$357,837[d]	$298,707[d]	$177,480[d]	$ 13,770[d]

[d] Deficit.

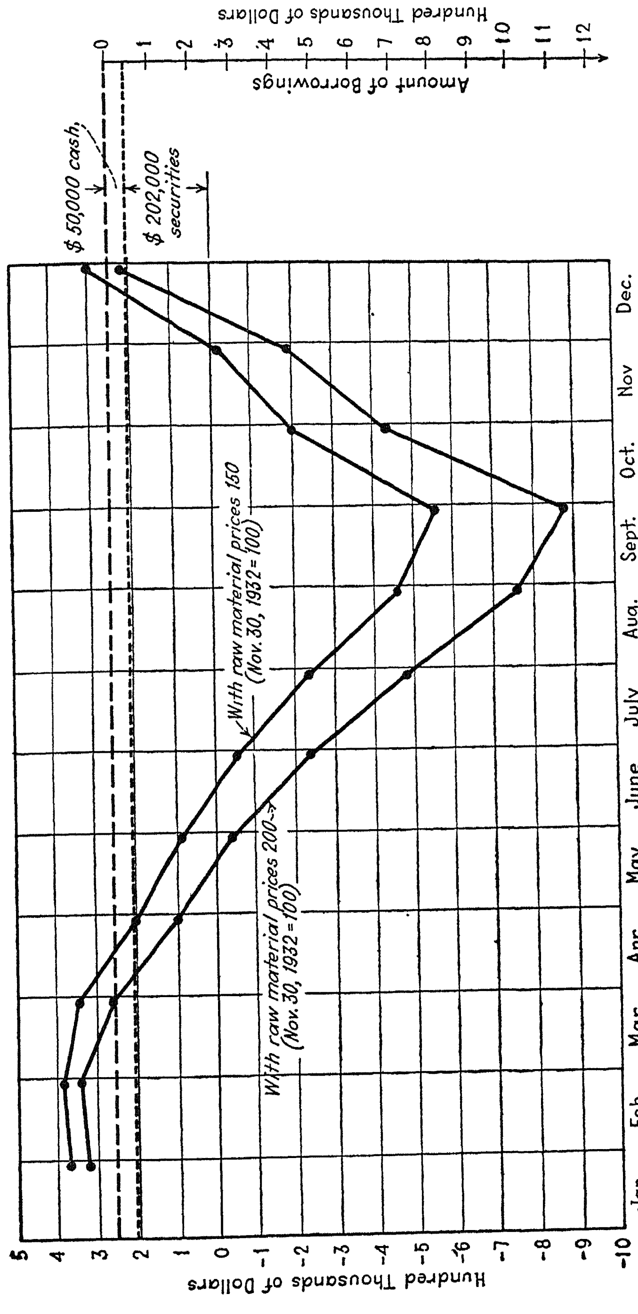

EXHIBIT 3.—Fairfield Manufacturing Company. Estimated cash and securities, and required borrowing, ends of months in 1934 (assuming annual sales of 75,000 units).

Exhibit 4
Cotton Prices
New York—Spot, Middling Uplands
Unit: Average daily prices in cents per pound

Month	1932	1933	Month	1932	1933
January	6.65	6 24	July	5 88	10 74
February	6.85	6 05	August	7.48	9.56
March	6.85	6 39	September	7 70	9.64
April	6.17	7.02	October	6.57	9 59
May	5.73	8.65	November	6.22	10.04
June	5.27	9.47	December	5.95	10.17

Source. *Standard Statistical Bulletin.*

Exhibit 5
Fairfield Manufacturing Company
Important Working Capital Items, Monthly, 1933
(In thousands of dollars)

End of	Accounts receivable	Finished goods	Raw materials	Bank loans	Cash and securities
January	$ 49	$ 69	$183	...	$647
February	34	96	263	...	543
March	198	137	256	...	376
April	53	119	323	...	416
May	51	145	387	$ 50	357
June	106	188	441	150	312
July	238	169	427	200	300
August	241	162	348	200	304
September	322	126	356	200	310
October	184	105	445	50	253
November	144	40	484	...	274
December	130	40	511	...	277

3. PIERCE-ARROW MOTOR CAR COMPANY (I)

READJUSTMENT OF CAPITAL STRUCTURE

Upon the consummation of the purchase from the Studebaker Corporation under the terms as given in Part II[1], the management of the Pierce-Arrow Motor Car Company asked the stockholders of the company to approve the following plan for recapitalization.

PLAN OF RECAPITALIZATION

The authorized capital of the company will be changed from 80,000 shares of 6% preferred stock (par $100), 197,250 shares of Class A stock (no-par value) and 230,125 shares of Class B stock (no-par value) to 750,000 shares of common stock of the par value of $5 per share.

The preferred stock will be reclassified by changing each share of preferred stock into 3.2 shares of new common stock, resulting in a total of 227,520 shares of new common stock outstanding.

The Class A stock will be reclassified by changing each share of Class A stock into one-tenth of a share of new common stock, or a total of 19,725 shares of new common stock.

The Class B stock will be reclassified by changing each share of Class B stock into one-twenty-fifth of a share of new common stock, or a total of 9,205 shares of new common stock.

Two hundred forty thousand shares of new common stock will be issued in exchange for the $2,000,000 note held by Studebaker dated November 1, 1932.

Open accounts due from the company to the Studebaker Corporation and subsidiaries in the amount of $108,188 will be cancelled.

The total amount of new common stock issuable under the plan will be 496,450 shares. This stock will have preemptive rights as to stock which may be hereafter issued other than that provided for in this plan.

In the letter to stockholders dated August 26, asking for their consent to this plan, the management pointed out the following advantages to be gained by recapitalization: (1) The company would be freed of $2,108,188 of debt and thus would be in a position to obtain additional credit; (2) the present impairment of capital would be wiped out and $2,000,000 added to the net worth of the company; (3) the capital structure would be simplified and "a medium created through which permanent capital could be secured."

[1] For additional information and financial data see Pierce-Arrow Motor Car Company (II), Sec. VII (p. 314).

On September 15, 1933, the stockholders of the Pierce-Arrow Motor Car Company gave approval to the plan as outlined, and application was made for listing the new $5 par value common shares on the New York Stock Exchange.

A pro forma consolidated balance sheet, together with a reconciliation of surplus, showing the effect of the recapitalization plan is given in Exhibits 1 and 2. Prices of the new common stock are shown in Exhibit 3.

1. Did the recapitalization of the company entirely solve its financial problems?

2. Appraise the statements of the management with respect to the recapitalization plan.

EXHIBIT 1

PIERCE-ARROW MOTOR CAR COMPANY AND SUBSIDIARY COMPANIES
PRO FORMA CONSOLIDATED BALANCE SHEET, AS OF JUNE 30, 1933

Giving effect as of June 30, 1933 to

1. The exchange of common stock for the previously issued stock of all classes.
2. The exchange of the $2,000,000 gold note for 240,000 shares of common stock.
3. The cancellation of Studebaker open accounts in the amount of $108,187.68.

ASSETS		
Cash		$ 241,321.52
Notes and accounts receivable, less reserve		495,411.39
Inventories, including finished cars, service parts, raw materials, work in progress, and supplies at plants and branches (at cost less reserves)		1,752,606.71
Total current assets		$ 2,489,339.62
Miscellaneous investments, etc., at cost less reserve		152,755.79
Insurance unexpired, prepaid expenses, etc.		126,003.82
Branch-house property not used in manufacturing operations		803,506.87
Land and buildings on the basis of appraisal in 1928, with subsequent additions at cost, and machinery, equipment, etc., at cost	$11,189,419.25	
Less: Reserve for depreciation	4,606,147 48	
Total capital investments		$ 6,583,271.77
Goodwill, patents, and trade-marks		1.00
Total assets		$10,154,878 87
LIABILITIES		
Notes payable		$ 461,394.33*
Accounts payable—Studebaker		98,039.43
Accounts payable—others		348,097.48
Deposits on sales contracts		14,901.73
Accrued expenses		175,938.28
Sundry creditors, etc.		69,794.89
Amount payable to preferred stockholders of old company upon surrender of shares not yet exchanged		310.00
Total current liabilities		$ 1,168,476.14
Real estate purchase mortgages, maturing in October, 1934		326,250.00
Sundry reserves		128,187.68
Capital stock: Issued and outstanding 496,450 shares of $5 par value		2,482,250.00
Surplus	$6,157,902 73	
Less: Transfer to sundry reserves	108,187.68	
		6,049,715.05
Total liabilities		$10,154,878.87

NOTE: Contingent liability on repurchase agreement in respect of customers' notes to finance company for car sales at June 30, 1933—$575,124.39.

* Of this amount $111,394.33 represents a liability of a subsidiary selling company secured by 33 of the finished cars, valued at $79,613 42, included in inventory, and by funds received or receivable from the sale of other cars, in the amount of $31,780.91.

Source: *Commercial and Financial Chronicle.*

EXHIBIT 2

PIERCE-ARROW MOTOR CAR COMPANY

RECONCILIATION OF SURPLUS FOR PURPOSE OF PRO FORMA BALANCE SHEET, JUNE 30, 1933

Capital stock and surplus	$7,873,067.71
Less: Surplus deficit	1,341,102.66
Capital stock and surplus	$6,531,965.05
6% gold note due 1937	2,000,000.00
	$8,531,965.05
Open account due Studebaker to be canceled	108,187.68
	$8,640,152.73
496,450 shares new common stock at $5	2,482,250 00
Capital surplus as shown	$6,157,902.73
Less: Transfer to sundry reserves	108,187.68
	$6,049,715.05

Source: *Commercial and Financial Chronicle.*

EXHIBIT 3

PIERCE-ARROW MOTOR CAR COMPANY

STOCK QUOTATIONS

OF

$5 PAR COMMON

NEW YORK STOCK EXCHANGE

Date	Low	High
1933:		
November*	4½	7½
December	3	4½
1934:		
January	2	4¾
February (1–15)	3⅞	6¼
February 15	5	6¼

* The stock was not listed until November.
Source: *Bank and Quotation Record.*

4. MANSTER GAS AND ELECTRIC COMPANY[1]

DETERMINATION AND DISTRIBUTION OF SECURITIES OF A PUBLIC SERVICE CORPORATION

The financial budget of the Manster Gas and Electric Company in 1924 required a capital expenditure of $5,200,000 for the proposed expansion of gas and electric plants, transmission lines, and distribution systems. There were two problems in connection with the issue of securities to finance this expansion: first, what type of security should be issued; second, should the company attempt to distribute securities through its own salesmen or should the issue be sold to a syndicate of investment firms?

The Manster Gas and Electric Company furnished the entire gas and electric light and power for a Middle Western city, including all the power used by street railways. Its operations extended also into the suburbs and surrounding counties. The territory served by the electric distribution system embraced an area of 425 sq. miles and by the gas distribution system 140 sq. miles. The population of the territory served by the company was estimated at the beginning of 1924 to be in excess of 1,000,000.

In its local division, the company had generating stations aggregating 286,000 hp. In addition, installations aggregating 69,290 hp. were to be completed during 1924. The company also had an advantageous contract for power from the hydroelectric development on a river about 40 miles from the city. The gas plant of the company at the beginning of 1924 had a capacity of 78,000,000 cu. ft., which was to be extended to 87,100,000 cu. ft. during that year.

The number of customers of the company had increased from 128,700 consumers of gas and 20,800 of electricity in 1910 to 214,500 of gas and 163,800 of electricity at the end of 1923. A wide variety of manufacturing establishments, distributing companies, apartment houses, office buildings, hotels, restaurants, and newspaper printing companies were furnished with light and power by the company. As a result of this wide diversification in the industries served, the company's physical volume of business had shown an almost uninterrupted increase since 1910.

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

The owners of the company's common and preferred stock totaled 11,449, of whom 7,662, or about 67% were residents of the state in which the company operated. Over 60% of the owners of the common stock of the company lived within the city. The owners of the bonds of the company and its subsidiaries were 12,917; they held about three-fifths of the total outstanding bonds, while the remainder were retained as investments by corporations such as savings banks and insurance companies. The earnings and financial condition of the company had been excellent for the past 10 years, as indicated by Exhibits 1 and 2.

EXHIBIT 1
MANSTER GAS AND ELECTRIC COMPANY
EARNINGS, 1914–1923

Year ending	Gross income	Operating expenses and taxes	Net earnings	Fixed charges	Surplus available for dividends and depreciation
June 30, 1914..	$ 8,321,166	$ 4,333,968	$ 3,987,198	$2,037,996	$1,949,202
June 30, 1915 .	8,826,223	4,649,558	4,176,665	2,132,470	2,044,195
June 30, 1916..	9,661,300	5,002,500	4,658,800	2,054,076	2,604,724
June 30, 1917..	11,048,452	5,824,215	5,224,237	2,173,890	3,050,347
June 30, 1918..	13,805,467	8,340,390	5,465,077	2,692,742	2,772,335
Dec. 31, 1919..	16,657,703	10,416,778	6,240,925	2,968,709	3,272,216
Dec. 31, 1920..	20,063,496	13,587,329	6,476,167	3,217,750	3,258,417
Dec. 31, 1921..	21,596,105	13,759,957	7,836,148	3,852,889	3,983,259
Dec. 31, 1922..	26,488,909	14,887,245	11,601,664	4,427,394	7,174,270
Dec. 31, 1923..	28,888,209	16,365,170	12,523,039	4,201,724	8,321,315
10-year average	16,535,703	9,716,711	6,818,992	2,975,964	3,843,028

In 1919, out of a total capitalization of $89,134,500, $67,928,-900, or 76.21%, was bonds and the remainder was divided between common and preferred stock. At the end of 1923, out of a total capitalization of $109,323,630, only 68.82% of the total was bonds.

An issue of common stock was not considered because the holders of the existing common stock who controlled the company did not desire to weaken their position or to subscribe additional money. Preferred stock had no voting powers except with respect to a proposed amendment to the charter of the company, a proposed sale of property or assets, or a proposed dissolution of the

EXHIBIT 2

MANSTER GAS AND ELECTRIC COMPANY

CONSOLIDATED CONDENSED BALANCE SHEET, AS OF DECEMBER 31, 1923

ASSETS		
Invested Assets:		
Plant and Equipment, including Real Estate and Franchises		$110,489,493
Unfinished Plant Investment		328,061
Investment in Stocks and Bonds		1,163,717
Total Invested Assets		$111,981,271
Current Assets:		
Cash on Hand, in Banks, and with Fiscal Agents	$4,292,759	
Accounts and Notes Receivable	3,607,680	
Subscriptions to Capital Stock—Common	73,762	
Subscriptions to Capital Stock—Preferred Series B	15,716	
Materials and Supplies	3,913,571	
Work in Progress, Account of Consumers	44,909	
Other Current Assets	2,496,650	
Total Current Assets		14,445,047
Advances: Employees' Stock Subscriptions		867
Sinking Funds, Invested		991,275
Sinking Funds, Uninvested		120,123
Sundry Deferred Charges		77,094
Total Assets		$127,615,677
LIABILITIES		
Capital Liabilities:		
Manster Gas and Electric Company:		
Common Stock		$ 22,603,750
Common Stock—Subscribed		188,110
Preferred Stock, Series A (8%)		6,500,000
Preferred Stock, Series B (7%)		2,538,770
Preferred Stock, Series B (7%)—Subscribed		61,230
Stuart Electric Company, Preferred Stock (5%)		1,300,000
Union Building Company, Preferred Stock (6%)		894,920
Bonds		75,236,850
Total Capital Liabilities		$109,323,630
Current Liabilities:		
Accounts Payable	$ 913,270	
Customers' Extension Deposits	467,189	
Unpaid Wages (Not Due)	103,072	
Accrued Interest on Bonds and Notes	1,470,826	
Bonds called for Redemption and Term Notes Matured	15,600	
Dividends Payable January 2, 1924	626,420	
Total Current Liabilities		3,596,377
Sinking Fund Reserves		202,475
Sundry Reserves and Accruals		763,857
Reserve for Depreciation (Renewals)		6,940,190
Reserve for Contingencies		531,186
Funded Debt Retired through Surplus		304,850
Surplus		5,953,112
Total Liabilities		$127,615,677

company; it had full voting rights if the company failed to pay full dividends on preferred stock for a whole year. Provisions in the authorization for the issue of preferred stock made it unnecessary that additional issues of stock be offered to previous holders of either common or preferred stock.

Series A of the preferred stock was callable at any time on 60 days' notice at 125 and dividends; Series B was callable under the same conditions except that the call price was 110. The authorization specified also that at no time should preferred stock be issued and outstanding in excess of the amounts of common stock issued and outstanding and not held or owned by the company. No future issues of preferred stock were to be made unless net earnings, over and above operating expenses,[1] were at least twice annual dividend requirements of preferred stock outstanding and proposed to be issued.

The company had excellent credit standing; it could have issued either bonds or preferred stock with the assurance of a desirable market at the prevailing rates for the most valued types of securities. The preferred stock of the company had sold to yield between 6.96 and 6.5% per annum since October, 1923. The yields to investors on purchases of the bonds of the company had ranged between 6.05 and 5.45% per annum. In both cases the tendency since the first of the year had been toward higher prices and lower yields with a differential of approximately 1% in favor of bonds. Investment houses usually were willing to distribute bonds of public utility companies for a compensation of from 2 to 3 points; charges for a stock issue ordinarily were at least 5 points. This was chiefly because bonds were sold in larger blocks than stocks and because many investors of small amounts would buy bonds who would not wish to purchase stocks. As a consequence, the bankers' selling costs were lower for bonds than for stocks.

One of the chief difficulties of most public service corporations was in the relationship with their customers and with public service commissions. A few companies had constant litigations before the commissions on account of the demands of customers to have the rates lowered. It was probable that, if 4,000 or 5,000 customers became security holders in the company, an interest favorable to the company would be created, and, as a result, the relations of the company with the public, with customers, and

[1] Including allowance for depreciation and other reserves.

with public service commissions might be made even more favorable. It might be easier to sell stocks than bonds to customers, moreover, because stock denominations were smaller than those of bonds. In addition, payment for stock on the installment plan was customary but was unusual in the case of bonds, although there was a growing tendency among some investment firms to sell bonds on the installment plan.

If the company attempted to distribute securities through its own salesmen, selling costs probably would be smaller than if the distribution were made through an investment syndicate. The company had a reputation throughout the territory in which it operated as issuing reliable securities, and the management believed that, with a bonus of not over 1% to its salesmen and collectors, the issue could be sold without impairing their efficiency in the performance of other duties. In addition, the use of the installment plan would facilitate sales. Many consumers already were stockholders and probably in most instances would be glad to have an opportunity to purchase additional securities. It would be possible to get wide distribution by limiting the amount of securities sold to any one individual. Concentration of selling effort on the company's consumers would be likely to have its effect toward prevention of future demands for lower rates. In addition, the company believed that the number of customers was large enough to take care of the whole issue.

On the other hand, the selling of securities to customers would limit the area over which the securities were distributed. A wider distribution would be given if the sales were made through a banking syndicate. This was especially true in the case of the Manster Gas and Electric Company, for the firms to which it was accustomed to sell securities were located in the eastern part of the United States and made the majority of their sales in that territory. Wide geographic distribution had two chief advantages. In the first place, it served to make the issue more generally known, and as a consequence future issues of similar securities by the company could be marketed more easily, since unfavorable conditions in one locality would be offset by more favorable conditions elsewhere. In the second place, if the securities were sold in a limited territory a disaster in that territory, such as a crop failure, would result in having large blocks of the security thrown on the market. In that event the price of the security would inevitably decline sharply. The company's

credit position would be weakened because its standing was judged principally by the price at which its securities were selling currently.

It was important also for a company which expected to issue securities from time to time to maintain friendly relations with investment firms. In periods of depression in the stock market and in business generally, the company might find it impossible to make a market for its securities without aid from the bankers.

1. Should the Manster Gas and Electric Company have sold securities to customers through its employees?

2. What type of securities should it have issued?

5. BRUCE & COMPANY

INSURANCE OF ACCOUNTS RECEIVABLE

Mr. Morse, the executive in charge of credit and legal matters for Bruce & Company, informed a representative of the General Credit Insurance Company in January, 1933, that he questioned the advisability of renewing the insurance of accounts receivable which his company had carried for the first time in 1932.

In three mills located in an eastern state, Bruce & Company produced high-quality kraft paper, from which it manufactured paper bags and other paper products. Sales of these products, normally about $5,000,000 annually, were made chiefly to grocery wholesalers and paper jobbers, although in a limited number of cases directly to chain-store companies. Accounts of these customers were of small or moderate size, the largest seldom exceeding 1½% of Bruce & Company's total yearly sales. Ordinary credit terms were 2% 30 days, net 60 days, but in a few cases concerns were permitted to deduct the full discount despite the fact that their accounts were outstanding for more than 30 days. Since a large proportion of the customers took the discount regularly, accounts receivable on the books of Bruce & Company seldom exceeded 45 days' sales, even though nearly 20% of these accounts were customarily overdue.

Upon the receipt of an order Mr. Morse reviewed the credit standing of the account, whether old or new, and for these investigations used the reports and ratings of the recognized credit agencies. In the case of old customers, however, he placed chief reliance upon their credit record with Bruce & Company. As the result of these policies, annual losses on bad debts during the preceding six years had been limited to the following amounts:

1927	$2,339
1928	5,055
1929	5,296
1930	855
1931	1,806
1932	2,300

The policy which Bruce & Company took out in 1932 provided that claims could be made only on past due accounts which had been filed with the insurance company for collection at a nominal cost. It applied, moreover, only to accounts with firms rated by

R. G. Dun as having pecuniary strength in excess of \$5,000 and "high" or "good" credit standings. The policy also specified the maximum amounts by which losses in each of Dun's groups were covered. These coverages were arranged to conform to the typical distribution of Bruce & Company's accounts by credit ratings and to give ample protection throughout the range of credits. Bruce & Company, on its part, contracted to assume not only a normal loss of \$4,900, plus 20% of the greatest single insured loss, if any such loss in excess of \$14,700 were incurred, but also to meet, as coinsurer, 10% of insured losses above the normal. The premium charged for this policy by the insurance company was \$3,199.

Mr. Morse informed the representative of the General Credit Insurance Company that, for his company, the advantages were not sufficient to warrant continuing the insurance of accounts receivable. He had found the policy carried in 1932 unsatisfactory in several respects. In the first place, accounts originally accepted as insurable were eliminated because of changes in their credit ratings during the year. In the second place, even when accounts remained insurable, changes in credit rating resulted in a regrouping which made predetermined group coverages inadequate. Furthermore, Mr. Morse had frequently considered it inexpedient to risk offending a customer by filing an overdue account for collection. Finally Mr. Morse stated that, in his opinion, insurance of accounts receivable was unsound in principle for concerns such as Bruce & Company. He believed that credit insurance was desirable only in the case of companies which had either few customers, extremely localized markets, or large accounts insurable by name.

In reply, the representative of the insurance company asserted that Mr. Morse's opinions implied a misunderstanding of the basic principles of credit insurance. An individual concern could not assume its own credit losses as cheaply as an insurance company since it did not have sufficient diversification of risk. Even if a company created a reserve for bad debts, the money still remained invested in the enterprise and therefore was exposed to the risks inherent in the business. Moreover, competent credit management could not entirely prevent heavy losses on occasion. The fact that banks regarded favorably requests for loans from companies carrying credit insurance was an advantage which should not be overlooked. As for Mr. Morse's objections to

placing any accounts with the insurance company for collection, the representative pointed out that concerns which permitted their accounts to become overdue were usually undesirable customers.

As an inducement to Bruce & Company to continue a credit insurance program, the representative of the General Credit Insurance Company offered to lower the 1932 premium and to reduce the normal loss that the company was to assume. He suggested that Bruce & Company could purchase, instead of a standard policy, either one which provided for limited collections or, if it preferred, a policy insuring by name a few of the large accounts.

1. Should Bruce & Company have insured its accounts receivable in 1933? Should the company have changed either to a noncollection or to an individual-accounts type of policy?

2. Should the company have carried credit insurance in 1932?

6. SIMPLEX COMPANY

ORGANIZATION OF FINANCE COMPANY

In October, 1932, the officers of the Simplex Company, which was organized in Chicago earlier in the year for the purpose of leasing a greatly improved type of accounting machine to banks and other users, were considering the advisability of forming a finance company which they believed would be of material assistance in financing the distribution of their product.

This new product was the result of several years of careful experimentation. In a number of actual tests it had been demonstrated conclusively that it possessed numerous important advantages not offered by any similar machine of other make. These advantages were fully protected by patent rights in the United States and in most foreign countries as well.

The Simplex Company had made satisfactory arrangements for the production of the new machine with a well-known local manufacturing concern. The latter had contracted to deliver machines to the company according to the following schedule:

Machines	Price Each, f.o.b. Factory
First 100	$2,000
Second 100	1,500
Third 100	1,200
Additional 100's	1,000

The manufacturer was to be paid in full by the Simplex Company for each machine upon shipment. It was expected that about 350 machines would be placed in 1933.

The Simplex Company was planning to begin operations in Chicago, Michigan, Philadelphia, New York, and New England early in December, 1932, and in other parts of the country later on. For at least the first few years it expected to lease about half its machines through its own offices and the remaining half through selected distributors.

In the case of machines placed directly through the company's own offices, two classes of leases were provided for, as follows:

Class 1: Lease to a concern of high credit rating. No down payment required. Lessee to pay a fixed rental of $100 a month for each machine used.

Class 2: Lease to a concern of lower credit rating. Lessee to make a down payment, on signing lease application, of five months' rental

charge, or $500; and to pay a fixed rental of $100 a month beginning with the sixth month.

Distributors selected by the Simplex Company were to lease machines from the company and then sublease them to users on the same terms as those just specified. These distributors were to sublease machines only to responsible users whose applications for leasing had been approved by the Simplex Company. Title to all machines was to remain in the company at all times. For each machine ordered, the distributor was to pay the company the total amount of $3,000 (plus shipping charges). Of this amount, $700 plus delivery charges was to be paid on shipment of the machine. The distributor was to give the company his notes for the unpaid balance of $2,300, together with the sublease indorsed to the company, which he secured from the ultimate lessee. These notes were to be paid at the rate of $100 a month. The Simplex Company planned to indorse the notes, secured by the sublease, and then discount them either at its own banks or with a finance company which the officers of the former company thought it might be advisable to organize.

The officers in favor of organizing such a company pointed out that finance companies had for a number of years been used successfully in financing the distribution of a wide range both of producers' and of consumers' goods sold on the installment plan. Partly because of their assumption of greater risks, and partly because of the costs involved in handling the collection of installment notes, they customarily charged for their services rates higher than those charged by commercial banks on direct loans to customers. Most finance companies obtained from outside sources a part of the capital used in their business.

The minimum period for which machines could be leased was to be 10 years, or one-half their estimated life. In case it developed new machines with improvements, the Simplex Company agreed to substitute these for the old machines. It agreed also to supply free of charge to users all servicing which any of its machines might require.

1. Should the Simplex Company have organized a finance company, or should it have made some other arrangement for financing the distribution of its product?

2. Indicate how to determine approximately the amount of capital required by the Simplex Company.

3. How should this capital have been obtained?

VII

VALUATION AND CONSOLIDATION

1. DORSEY MANUFACTURING COMPANY

VALUATION OF ASSETS FOR PURCHASE BY COMPETITOR

At the annual meeting of the Dorsey Manufacturing Company in February, 1932, by vote of two-thirds of the common stock outstanding, the treasurer was instructed to negotiate for the sale of the entire assets of the Dorsey Manufacturing Company to its largest competitor, the Wachusett Cotton Company. Established in 1866, the Dorsey Manufacturing Company had been successfully engaged in the manufacture of cheese cloth, cotton gauze, and similar products up to the business depression of 1921. Its property, located in two small towns in Connecticut, consisted of two spinning and weaving mills and one finishing mill; the town in which the finishing mill was situated was without rail connections. The buildings in both towns were of the post-Civil War type of stone construction and equipped, in part, with machinery forty to fifty years old. In addition to its mill property the Dorsey Manufacturing Company owned about 75 tenements occupied by its employees.

With the renewal of business activity after the depression of 1921, the company was faced with the problem of reducing production costs and creating new sales outlets to meet competition from manufacturers with mills in the South. After a careful survey of the company's condition and prospects, the owners decided to replace the most obsolete of its equipment with new machinery costing about $1,250,000. Funds for this purpose were raised by an issue of 7½% serial debentures dated July 1, 1922, and maturing $125,000 annually to July 1, 1932. A portion of this issue was taken by the machinery manufacturers in part payment for the new equipment. It was expected at the time that the new machinery would result in operating economies sufficient to pay for itself over the 10-year period.

To increase its sales, the company decided to supplement its established jobber clientele with direct selling to large consumers, such as government and state institutions. Although a fair volume of business was secured from these sources, it was taken at prices that did not permit a profit for the company, and consequently the treasurer was unable to pay off the serial debentures as planned. In 1925 an agreement was made with a committee representing the debenture holders whereby all maturities were to be extended to July 1, 1932. As indicated in Exhibits 1 and 2, by February, 1932, several years of operating losses had placed the company in a position where neither payment nor refunding of its debentures in the following July was possible.

At the stockholders' meeting in February, 1932, Mr. Jordan, president of the Dorsey Manufacturing Company, pointed out that, despite the financial position of his company, a fair offer from the Wachusett Cotton Company could be hoped for. The latter company manufactured the same cotton products as did the Dorsey Manufacturing Company and was a competitor for the sales of over $3,000,000, which the Dorsey company had averaged for the past five years. The jobber clientele of the Dorsey company consisted of well-established firms and represented satisfied customers for the company's products, many of which were sold under long-established and well-advertised brands. Mr. Jordan stated that the Wachusett Cotton Company should be interested not only in purchasing the goodwill represented by these accounts but also in acquiring the entire property of the Dorsey Manufacturing Company to prevent its getting into the possession of competitors.

In discussing the position of the debenture holders, the president admitted that the company could not be dissolved and its assets sold without providing for their claims. The Wachusett Cotton Company might, he thought, assume these obligations or make a sufficiently large payment in cash so that the treasurer could meet these maturities. On the other hand, if the Wachusett company made an offer in securities, the debenture holders would have to agree to the terms of the offer before a sale of the Dorsey Manufacturing Company could be effected. As the principal owner of the company, Mr. Jordan asserted that he was not interested in making a profitable deal for himself or the other common stockholders. By selling the company, he hoped to insure the continued operation of the mills since the entire popu-

lation of the towns in which they were located was dependent upon the company for its livelihood.

The Wachusett Cotton Company owned weaving and spinning mills in North Carolina and a finishing plant in Connecticut. Under an aggressive management the plant had expanded profitably during the period which had witnessed the decline of the Dorsey Manufacturing Company. The president of the Wachusett Cotton Company said he would be interested in purchasing the Dorsey Manufacturing Company not only to acquire its goodwill but also to gain additional production capacity, which his company could use. However, since production costs for spinning and weaving were much lower in the South, he was of the opinion that the Dorsey Manufacturing Company would be worth acquiring only at a price considerably below its book value. He stated, furthermore, that he would be interested in negotiating for the purchase of the Dorsey Manufacturing Company only if it could be effected by an exchange of securities.

The exhibits on pages 276–279 show balance sheets and earnings statements of the two companies for the five-year period preceding the negotiations for the purchase.

1. Should the Wachusett Cotton Company have purchased the Dorsey Manufacturing Company?

2. Draw up a plan, equitable to all parties concerned, for effecting the purchase of the Dorsey Manufacturing Company.

EXHIBIT 1
DORSEY MANUFACTURING COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1927	1928	1929	1930	1931
ASSETS					
Cash	$ 138,339	$ 94,615	$ 129,228	$ 91,984	$ 136,231
Accounts Receivable—Customers	390,095	395,322	378,549	340,919	198,922
Accounts Receivable—Employees	....	....	....	....	3,331
Less: Reserve for Doubtfull Accounts	....	....	−4,500	−4,500	−4,500
Inventory:					
Cotton	602,104	798,711	5,059	673	7,634
Work in Process	....	....	102,612	74,919	53,736
Cloth—Unfinished	....	....	248,971	259,955	198,805
Cloth—Finished	....	....	148,588	111,767	66,010
Supplies	....	....	86,915	81,227	90,205
Total Current Assets	$1,130,538	$1,288,648	$1,095,422	$ 956,944	$ 750,374
Deferred Charges:					
Prepayments	43,773	48,334	60,670	32,143	21,681
Development Expense	....	....	....	45,000	45,940
Plant at Book Value	1,466,101	1,478,492	2,063,123	2,208,530	2,222,252
Less: Reserve for Depreciation	....	....	−643,421	−730,067	−821,483
Investments at Cost	3,450	7,187	7,187	7,187	7,187
Total Assets	$2,643,862	$2,822,661	$2,582,981	$2,519,737	$2,225,951
LIABILITIES					
Accounts Payable	$ 185,809	$ 332,775	$ 145,910	$ 191,556	$ 104,751
Accrued Liabilities, Pay Roll, Interest, Taxes	40,548	38,941	31,818	29,694	28,776
Serial Bonds, Extended to 1932	1,000,000	1,000,000	916,000	916,000	880,000
Total Current Liabilities	$1,226,357	$1,371,716	$1,093,728	$1,137,250	$1,013,527
Capital Stock:					
Common $100 Par	450,000	450,000	450,000	450,000	450,000
7 % Cumulative Preferred, $100 Par	438,700	438,700	438,700	438,700	438,700
Surplus	528,805	562,245	600,553	493,787	323,724
Total Liabilities	$2,643,862	$2,822,661	$2,582,981	$2,519,737	$2,225,951

NOTE: The preferred stock had preference as to assets and dividends. In involuntary liquidation it was entitled to 100 and dividends. In voluntary liquidation, it was entitled to 110 and dividends. In the event of default of four consecutive quarterly dividends, it had exclusive voting power.

Neither the preferred nor the common stock was listed or quoted.

EXHIBIT 2

DORSEY MANUFACTURING COMPANY

EARNINGS STATEMENT, YEARS ENDED DECEMBER 31

Item	1927	1928	1929	1930	1931
Sales	$3,291,483	$2,832,717	$3,498,043	$3,167,905	$2,454,392
Less:					
Cash discounts	....	....	69,276	60,388	46,608
Freight out	....	....	39,359	41,558	38,053
Allowances	....	....	2,917	12,233	9,648
Net sales	....	....	$3,386,491	$3,053,726	$2,360,083
Gross profit	....	....	$ 435,678	$ 258,585	$ 269,192
Less:					
General overhead	....	....	59,900	58,370	56,219
Selling expense	....	....	175,530	174,756	167,507
Advertising	....	....	46,529	52,799	69,989
Operating profit	$ 219,050	$ 154,885	$ 153,719	$ 27,340[d]	$ 24,523[d]
Less: Interest	80,050	82,840	80,606	72,075	66,330
Earnings after interest	$ 139,000	$ 72,045	$ 73,113	$ 99,415[d]	$ 90,853[d]
Less: Other charges	28,771	25,017	14,860	15,036	10,444
Balance	$ 110,229	$ 47,028	$ 58,253	$ 114,451[d]	$ 101,297[d]
Other income	4,940	7,367	10,428	7,686	4,662
Net earnings	$ 115,169	$ 54,395	$ 68,681	$ 106,765[d]	$ 96,635[d]
Less: Special expense	....	20,955	30,373		
Less: Inventory charge-off	....	....	....	....	73,428
Net carried to surplus	$ 115,169	$ 33,440	$ 38,308	$ 106,765[d]	$ 170,063[d]

NOTE: No dividends were paid on common stock after 1920.
No dividends were paid on preferred stock after the first quarter of 1922.

[d] Deficit.

EXHIBIT 3
WACHUSETT COTTON COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1928	1929	1930	1931
ASSETS				
Cash and Call Loans	$ 3,164,430	$ 1,432,810	$ 1,885,352	$ 2,532,706
Accounts and Notes Receivable (Net)	4,129,078	3,935,284	3,515,495	2,906,605
Inventories—at Lower of Cost or Market	6,034,965	7,682,684	4,361,143	3,601,002
Marketable Investments	61,689	67,665	67,775	73,965
Total Current Assets	$13,390,162	$13,118,443	$ 9,829,765	$ 9,114,278
Treasury Debenture Bonds (at Cost)*	373,179	458,651	335,142	614,915
Treasury Preferred Stock (at Cost)†	....	272,810	....	159,307
Miscellaneous Investments	10,593	15,733	21,310	27,699
Unexpired Insurance and Prepaid Expenses	1,096,209	184,704	199,001	245,460
Unamortized Discount on Debenture Bonds	....	896,700	824,683	754,284
Plant, Less Depreciation	12,517,519	13,815,567	13,352,699	12,445,589
Trade-marks, Patents, etc.	97,500	273,656	271,270	271,270
Goodwill	1	1	1	1
Total Assets	$27,485,163	$29,036,265	$24,833,871	$23,632,803
LIABILITIES				
Bankers' Acceptances, Secured by Cotton	$ 1,856,926	$ 3,126,760	$ 1,016,123	
Accounts Payable	851,349	936,137	427,731	$ 521,602
Accrued Items	405,483	443,585	413,565	365,950
Dividends Payable	156,118	92,539	89,967	89,154
Provision for Federal Taxes	199,883	117,400	46,580	110,882
Total Current Liabilities	$ 3,469,759	$ 4,716,421	$ 1,993,966	$ 1,087,588
Noncurrent Accounts Payable	215,886	262,763	142,495	112,500
Reserves	....	....	....	150,000
Twenty-year 5½ % Debenture Bonds, 1948	9,750,000	9,607,500	9,322,500	9,037,500
Preferred Stock of Subsidiaries	1,891,600	1,891,600	1,891,600	1,890,100
$6 Preferred Stock, No-par Value	6,000,000	6,000,000	5,643,900	5,643,900
Common Capital Stock, No-par Value	2,509,813	2,525,150	2,571,240	2,585,190
Capital Surplus	2,685,542	2,685,542	2,735,530	2,735,530
Earned Surplus	962,563	1,347,289	532,640	390,495
Total Liabilities	$27,485,163	$29,036,265	$24,833,871	$23,632,803
* Par value of treasury bonds	....	$ 480,000	$ 387,000	$ 650,500
† Stated value of treasury preferred stock	....	306,000	....	311,900

EXHIBIT 4
WACHUSETT COTTON COMPANY
EARNINGS STATEMENT, YEARS ENDED DECEMBER 31

Item	1928	1929	1930	1931
Profit before depreciation and charges	$2,417,900	$2,729,244	$1,556,358	$2,291,812
Less: Depreciation	826,938	1,008,778	1,098,858	1,144,193
Balance	$1,590,962	$1,720,466	$ 457,500	$1,147,619
Interest received	....	83,606	31,589	34,223
Total	$1,590,962	$1,804,072	$ 489,089	$1,181,842
Less:				
Bond interest	365,560	505,713	492,809	472,089
Other interest	100,072	162,965	109,113	17,229
Amortization of bond discount	....	57,836	68,238	45,084
Dividends on subsidiary preferred	131,209	131,041	131,984	133,631
Extraordinary charges	19,510	8,974	31,985	99,647
Provision for taxes, including prior years	90,000	101,419	43,236	220,792
Total charges	$ 706,351	$ 967,948	$ 877,365	$ 988,472
Net income	884,611	836,124	388,276[d]	193,370
Less preferred dividends	207,372	306,536	367,528	335,515
Earned on common stock	$ 677,239	$ 529,588	$ 755,804[d]	$ 142,145[d]
Less common dividends	76,189	144,862	58,845	
Balance to surplus	$ 601,050	$ 384,726	$ 814,649[d]	$ 142,145[d]
Old earned surplus	1,329,649	962,563	1,347,289	532,640
Adjustments	−968,136			
New earned surplus	$ 962,563	$1,347,289	$ 532,640	$ 390,495
Shares of common stock outstanding	385,353	386,551	392,314	397,063
Earned per share of common	$1.76	$1.37		

[d] Deficit.

2. ELECTRIC AUTO-LITE COMPANY

EXPANSION BY ACQUISITION OF THE MOTO METER GAUGE & EQUIPMENT CORPORATION

On January 17, 1934, the directors of the Electric Auto-Lite Company and Moto Meter Gauge & Equipment Corporation approved the acquisition of the latter by the former for approximately 300,000 shares of Auto-Lite common stock subject to the approval of the stockholders. The exchange was to be effected on the basis of one Auto-Lite share for each two and one-half Moto Meter shares.

In a letter to stockholders, C. O. Miniger, President of the Auto-Lite Company, made the following statements:

> It is the opinion of the board of directors that the present time is unusually opportune for your company to diversify its business, expand its operation, and thereby increase profits.
>
> It has successfully weathered the four years of depression, is in exceptionally sound financial position, but its earnings temporarily are retarded by low volume.
>
> In order for the company to acquire or develop additional items in the automotive accessory field, the attached formal notice asks your authority to increase the common shares from 1,000,000 to 1,500,000.
>
> The proposed acquisition of all the capital stock of Moto Meter Gauge & Equipment Corporation, or such part thereof, not less than 55%, as shall be deposited for exchange, upon a basis of exchange of one common share of this company for each two and one-half shares of said Moto Meter stock, will expand the company's operations into a new division of the automotive accessory field and should, in addition to bringing in valuable properties, substantially add to the company's earnings. The company has made substantial progress recently, and the outlook for the future of its business is bright.

Incorporated in 1922 to take over the properties of the Electric Auto-Lite divisions of the Willys Corporation, the Electric Auto-Lite Company became the largest independent manufacturer of starting, lighting, and ignition equipment and of storage batteries for automobiles and trucks in the industry. To a limited extent, the company also made automobile lamps, tools, and other similar products used by the automobile industry. The production of miscellaneous electrical products, such as electric clocks, flashlights, magnet wire, and arc welders gave the company a moderate amount of diversification.

Within a distance of 100 miles from Detroit were situated the company's plants for the manufacture of automotive equipment and magnet wire. Storage-battery plants located in Niagara Falls, Brooklyn, Indianapolis, and Oakland enabled the company to reach the replacement market without incurring excessive freight costs. For supplying the Canadian market, the company operated a battery plant at Toronto, Ontario, and an electrical equipment plant at Sarnia, Ontario.

Originally incorporated in 1922 with 250,000 shares of no-par common stock, the company replaced these shares with 650,000 no-par shares in 1928. With the exception of $3,000,000 spent for new construction, the company achieved expansion in that year and subsequent years by the issuance of additional common and preferred shares to acquire established companies. In February, 1933, the stockholders approved a change in the common stock from no-par to $5-par value. At the time of the merger, the outstanding capital stock consisted of $4,197,700, 7% cumulative preferred, $100-par, and 881,409 shares of $5-par common stock.

From the date of issue in June, 1928, the company had maintained dividends on its preferred stock at the rate of 7%; dividends were paid on common stock ranging from $1.50 quarterly in 1929 to $0.30 quarterly in the latter part of 1932. No dividends were paid on the common stock after January, 1933.

Up to the time of the merger drastic economies in operating expenses and the comparative stability of the battery-replacement business had made it possible for the company to operate at a profit in spite of the depression. During the past two years, however, earnings had decreased considerably, a circumstance which could be explained in part by loss of important contracts for automobile equipment. Formerly, for instance, the company sold its equipment to Ford, Hudson, Nash, Auburn, Willys-Overland, Hupmobile, Packard, and Studebaker. In the latter part of 1932, Studebaker and Willys-Overland were forced into receivership. Of even greater importance in its effect on earnings was the loss of all the Ford business when, in 1933, the Ford Motor Company began to make all its own starting, lighting, and ignition equipment.

Organized in July, 1929, the Moto Meter Gauge & Equipment Corporation obtained, in an exchange for its own securities, substantially all the properties and assets of the Moto Meter Co.,

Inc., and the Safe-T-Stat Co., manufacturers of dashboard equipment and temperature and controlling devices for automobile and marine motors. The new company then expanded these lines to include a complete dashboard indicator system for aeroplanes and many automobile accessories. The development of recording instruments for industrial use, the purchase of the right to manufacture a new fuel-saving device, and the acquisition of a lithographing company to supply its own demand for lithographic and etched dials, as well as to obtain additional dial business, gave the company further diversification of production. In the period between 1932 and 1934, developments included a novelty line, such as ash trays and pen stands bearing decorative designs, and a process of printing on glass, that permitted the stamping of colored labels on beer bottles in ink which could not be washed off. Manufacturing operations were carried on in two plants, one in Toledo, Ohio, and the other in La Crosse, Wisconsin.

At the time of the proposed merger, the capital structure of the Moto Meter Gauge & Equipment Corporation included one class of stock consisting of 741,766 common shares and no funded debt. In April, 1933, the stockholders had ratified a change in the capital stock from no par with a stated value of approximately $8.20 a share to $1 par value. The resulting difference was transferred to capital surplus from the capital account, and the past deficit was then deducted from the new surplus. The present company had paid no dividends.

The experience of the Moto Meter Gauge & Equipment Company had been the reverse of that of the Auto-Lite Equipment Company. After three years of deficits, the former company began to show improvement in its financial condition; operations in 1933 produced profits of $150,666. Better earnings were largely the result of a contract to supply the tail and cowl lights and all panel instruments, except speedometers, used by Chrysler Motors[1] for its various lines of cars. The company sold one or more of its products to practically every automobile manufacturer.

C. O. Miniger, President of Electric Auto-Lite Company, and R. G. Martin, President of Moto Meter Gauge & Equipment

[1] Chrysler was under contract through 1934 with Delco-Remy, a subsidiary of General Motors, as far as its starting, lighting, and ignition equipment was concerned. Interests affiliated with Chrysler were understood to own important stock holdings in Moto Meter.

Corporation, were to be president and vice president, respectively, of the combined concern, which was to be called Auto-Lite Moto Meter Corporation. Executives announced that, upon consummation of the merger, the Toledo plants of the two firms would be combined, but other plants would be operated as in the past.

The exhibits shown on pages 284–289 include financial information on both companies for a period of years just preceding the proposed merger.

Did the exchange offer of one share of Electric Auto-Lite Company for each two and one-half shares of Moto Meter Gauge & Equipment Corporation place a fair valuation upon the securities of the two companies?

EXHIBIT I
ELECTRIC AUTO-LITE COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1928	1929	1930	1931	1932	1933
ASSETS						
Land, Buildings, etc.*	$ 8,452,368	$11,280,460	$12,555,474	$11,303,557	$ 8,237,684†	$ 7,624,988
Patents, Goodwill, etc.	1	1	1	1	1	1
Investment in Affiliated Companies	2,306,501	442,800	531,801	1,352,271	1,217,851	1,013,260
Other Investments	46,240	44,112	63,587	67,171	53,770	99,026
Cash in Closed Bank	....	....	....	230,180	103,966‡	120,204
Advances to Employees	....	....	....	213,667	241,709	336,342
Mortgages Receivable	....	....	35,000	35,000	35,000	
Cash	701,914	3,776,881	1,027,273	592,929	501,644	1,008,726
Marketable Securities	35,788	6,749,955	1,587,770	1,400,682	416,229	260,160
Accounts and Notes Receivable (Net)	4,324,505	3,983,154	3,037,340	2,165,342	1,742,204	1,915,039
Inventories	4,297,823	4,365,754	3,144,399§	2,509,671§	1,954,132§	2,223,018§
Reacquired Stock‖	....	....	2,618,505	2,440,605	901,916	816,653¶
Deferred Charges	239,456	218,097	240,664	222,083	319,997	159,156
Total Assets	$20,404,596	$30,861,214	$24,841,814	$22,533,159	$15,726,103	$15,576,573

* Less depreciation: $3,364,315 in 1928, $4,359,933 in 1929, $5,130,538 in 1930, $5,322,770 in 1931, $5,661,774 in 1932, and $8,268,595 in 1933.
† Less $2,758,027 reserve for revaluation.
‡ Less $100,000 reserve.
§ At lower of cost or market.
‖ 48,425 common shares at market in 1932; 33,325 common at cost, 1931; 33,975 common at cost, 1930.
¶ Includes 170 shares of preferred stock.

EXHIBIT I (*Continued*)
ELECTRIC AUTO-LITE COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1928	1929	1930	1931	1932	1933
LIABILITIES						
Preferred Stock	$ 4,146,746	$ 4,160,198	$ 4,164,738	$ 4,197,700	$ 4,197,700	$ 4,197,700
Common Stock**	3,694,707	5,695,886	5,697,441	5,712,410	4,649,170	4,649,170
Reserve for Stocks Issuable	77,441	56,510	49,991			
Bank Loans of Subsidiaries	100,000	75,000	125,000	330,000	125,000	
Notes, Accounts, Commissions Payable	2,482,410	2,838,959	1,419,501	778,805	611,271	567,122
Subsidiary Notes Payable	....	....	....	132,425	30,000	
Accrued Taxes	851,314	349,797	312,743	75,861	86,660	72,471
Accrued Accounts				128,454	132,907	190,882
Tax Reserve	1,078,068	1,330,467	674,613	42,858	32,229	45,175
Other Reserves	....	189,840	30,000	....	....	12,500
Unearned Income	....	....	....	....	....	28,974
Acquired Surplus	7,973,910	1,415,801	1,257,789	851,418	860,905	865,571
Earned Surplus		14,748,756	11,109,998	10,283,228	5,000,261	4,947,008
Total Liabilities	$20,404,596	$30,861,214	$24,841,814	$22,533,159	$15,726,103	$15,576,573
Current Assets	$ 9,360,030	$18,875,744	$ 8,796,782	$ 6,668,624	$ 4,614,209	$ 5,406,943
Current Liabilities	4,511,792	4,784,063	2,561,857	1,488,403	1,018,067	888,150
Working Capital	$ 4,848,238	$14,091,681	$ 6,234,925	$ 5,180,221	$ 3,596,142	$ 4,518,793

** Represented by no-par shares ($5 par 1932): 884,697 in 1928, 926,229 in 1929, 926,568 in 1930, 929,834 in 1931, 929,834 in 1932.
NOTE: Contingent Liability: $392,400 in 1929 and $407,034 in 1932.
Sources: Moody's *Industrials; Standard Corporation Records* for 1933.

EXHIBIT 2

ELECTRIC AUTO-LITE COMPANY*

CONSOLIDATED INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1928	1929	1930	1931	1932	1933
Net sales	$47,355,280	$58,836,690	$38,409,093	$21,960,548	$13,106,647	
Cost of sales, etc.	37,849,535	47,604,702	32,291,731	17,859,574	11,660,345	
Depreciation	622,723	1,051,990	1,233,181	954,760	541,956	$525,507
Operating income	$ 8,883,022	$10,179,998	$ 4,884,181	$ 3,146,214	$ 904,346	$451,232
Other income	....	4,834,903†	800,392	791,054	478,472	237,998
Total income	$ 8,883,022	$15,014,901	$ 5,684,573	$ 3,937,268	$ 1,382,818	$689,230
Interest charges	39,173	92,698	19,188	15,586	18,759	4,858
Income taxes	1,065,031	1,208,000	640,907	7,849‡	‡	-
Net income	$ 7,778,818	$13,714,203	$ 5,024,478	$ 3,913,833	$ 1,364,059	$684,372
Preferred dividends	171,500	294,000	293,613	292,716	293,839	293,192§
Common dividends	3,489,049	5,399,765	5,578,746	4,639,500	1,766,685	
Dividends on regular stock	....	cr. 40,200	cr. 187,125	cr. 164,663	cr. 73,268	
Surplus for year	$ 4,118,269	$ 8,060,638	$ 660,756[d]‖	$ 853,720[d]¶	$ 623,197[d]	$391,180
Earned per share:						
Preferred	$187.59	$329.65	$120.64	$93.24	$32.50	$16.37
Common	8.60	14.49	5.11	3.89	1.15	.44
Number of preferred shares	41,467	41,602	41,647	41,977	41,977	41,807
Number of common shares	884,697	926,229	926,568	929,834	929,834	884,909**

* Includes subsidiaries from date of acquisition.
† Includes $4,000,000 nonrecurring dividend.
‡ No provision for United States income tax required.
§ After deducting $647 dividends on company's preferred stock held as investment.
‖ Before debiting $2,978,000 provision for decrease in value of marketable securities.
¶ Before adjustments of $458,947.
** Less treasury shares.
[d] Deficit.
cr. Credit.
Sources: Moody's *Industrials; Standard Corporation Records* for 1933.

EXHIBIT 4
MOTO METER GAUGE & EQUIPMENT CORPORATION
CONSOLIDATED INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932	1933
Net sales	$7,109,653	$3,104,221	$1,830,642	$1,425,397	
Cost of sales	5,495,860	2,557,383	1,550,526	1,230,087	
Gross profit from sales	$1,613,793	$ 546,838	$ 280,116	$ 195,310	$671,904
Depreciation	.....	160,712	166,898	165,831	149,967
Selling and service expenses	783,497	472,022	319,061	210,483	153,477
General and administrative expense	604,144	349,405	201,134	121,600	144,398
Laboratory research and other expenses	16,363	11,686	32,243	25,142	60,730
Operating profit	$ 209,789	$ 446,987[d]	$ 439,220[d]	$ 327,746[d]	$163,332
Other income	94,794	38,940	33,776	12,573	12,978
Total income	$ 304,583	$ 408,047[d]	$ 405,444[d]	$ 315,173[d]	$176,310
Discount and interest	84,996	31,717	14,004	11,999	
Other nonoperating expenses	33,387	198,118	40,360	42,791	
Inventory mark-down	....	....	67,239		
Federal taxes	25,050	....	....	....	25,644
Net income	$ 161,150	$ 637,882[d]	$ 527,047[d]	$ 369,963[d]*	$150,666
Earned per share	$0.32	$1.26[d]	$1.04[d]	$0.73[d]	$0.20
Number of shares	507,699	505,141	505,039	504,521	741,861

* Before adjustments of $667,613.
[d] Deficit.
Sources: Moody's *Industrials; Standard Corporation Records* for 1933.

EXHIBIT 5
PRICE RANGE OF THE COMMON STOCK

Date	Electric Auto-Lite Company		Moto Meter Gauge and Equipment Corporation	
	High	Low	High	Low
1933:				
September	23⅜	15⅞	6¾	3½
October	18½	11⅝	4⅞	3¼
November	17¾	13½	5⅜	3⅝
December 2–8	19¾	16½	6¾	5⅛
9–15	20¾	18½	8⅞	6¼
16–22	19⅛	17	8⅜	5⅜
23–29	20	18	8⅛	6¼
1934:				
January 2–5	20⅜	18½	8⅜	7½
6–12	19⅜	18¼	7⅞	7¼
13–19	23⅝	18⅝	9	7½
20–26	28¾	22	11½	8½

Sources: *Bank and Quotation Record; Commercial and Financial Chronicle.*

3. BASTIAN-BLESSING COMPANY

VALUATION OF SECURITIES EXCHANGED TO EFFECT CONSOLIDATION

In May, 1932, the stockholders of the Bastian-Blessing Company ratified a plan for expansion by the acquisition of the Russ Manufacturing Company through an exchange of stock. To effect a complete merger without sacrificing the goodwill of the Russ Manufacturing Company's name, the Bastian-Blessing Company organized a subsidiary in Ohio, the Russ Soda Fountain Company, to take title to the assets and business of the Russ Manufacturing Company. Stockholders of the latter company subsequently authorized the sale of their assets and the dissolution of their corporation in accordance with an exchange of shares outlined below. The plan further provided that the Bastian-Blessing Company should increase its directorate by two members, one of whom should represent the former Russ Manufacturing Company stockholders. With the conveyance of property and the exchange of stock completed, the acquisition became effective in July, 1932.

Incorporated in Illinois in 1908, the Bastian-Blessing Company was a large producer of carbonating machinery, soda fountains, and equipment for carbonic gas industries. Manufacturing operations of the company were carried on in plants in Chicago, where its main office was located, and in Grand Haven, Michigan. Upon the acquisition of the Russ Manufacturing Company, the management planned to transfer the manufacture of soda fountains and equipment from the Grand Haven to the Cleveland plant of the new company.

The original capital structure of the Bastian-Blessing Company included convertible preferred stock as well as common. By 1929, however, all the preferred stock either had been retired under sinking fund provisions or had been converted into common. The authorized common stock was increased in 1927 from 107,500 shares to 127,500 shares. In 1931, 115,000 shares were outstanding, of which 4,050 were held as treasury stock. The stock was listed on the Chicago Stock Exchange.

Incorporated in Ohio in 1901, the Russ Manufacturing Company manufactured soda fountains which, in line with recent trends in the industry, were equipped with mechanical refrigera-

tion. Other products of the company included water coolers and cooling units used in conjunction with mechanical refrigeration and beer-drawing apparatus. The company operated plants in Cleveland and Chicago. The plant in the latter city was obtained in 1929 through an exchange of shares which gave the company the entire capital stock of the Siren Mills Corporation. Since the Siren Mills Corporation manufactured chocolate products in various forms for the soda-fountain trade, this acquisition placed the Russ Manufacturing Company in a new field.

Purchase of the Siren Mills Corporation in 1929 made necessary a change in the capital structure of the Russ Manufacturing Company. The new capital stock issued to retire the original stock of the Russ Manufacturing Company and to acquire the Siren Mills Corporation consisted of 8,883 shares of $100-par 7% preferred, 8,733 shares of no-par cumulative Class A stock and 12,000 shares of no-par common stock (see Exhibit 5). In June, 1932, the capital structure was unchanged with the exception of 933 shares of the preferred stock which had been retired. The stock of the Russ Manufacturing Company was not listed on any exchange.

Under the plans for the merger, the newly formed subsidiary, the Russ Soda Fountain Company, issued 4,770 shares of preferred stock and 977 shares of common stock (see Exhibit 5). At the same time the Bastian-Blessing Company issued 3,180 shares of preferred stock and increased its authorized no-par common stock from 127,500 to 200,000 shares and its issued no-par common stock to 173,665 shares (see Exhibit 5). In the merger the following exchange of shares took place:

1. The Bastian-Blessing Company exchanged 58,665 shares of its common stock and 3,180 shares of its preferred stock for all the common stock (977 shares) of the Russ Soda Fountain Company.
2. The Russ Soda Fountain Company exchanged its entire issue of preferred stock (4,770 shares) plus the 3,180 shares of Bastian-Blessing Company preferred stock, which it had acquired as indicated under 1, for the 7,950 shares of Russ Manufacturing Company preferred stock.
3. The Russ Soda Fountain Company exchanged 58,665 shares of Bastian-Blessing Company common stock acquired as indicated under 1 for the 8,733 shares of Class A and the 12,000 shares of common stock of the Russ Manufacturing Company.

When the purchase of the Russ Manufacturing Company was being negotiated, the Bastian-Blessing Company management

announced its intention to redeem its preferred stock before the end of 1933 and to sell enough of the $1,000,000 accounts receivable of the Russ Manufacturing Company, as soon as the merger was completed, to redeem the entire issue of the Russ Soda Fountain Company preferred stock.

Balance sheets and income statements for the Bastian-Blessing Company for the years 1926–1931 are given in Exhibits 1 and 3. Financial statements of the Russ Manufacturing Company for the same period are shown in Exhibits 2 and 4. Exhibit 6 gives the price range of the common stock of the Bastian-Blessing Company yearly, 1927–1930, and monthly thereafter through June, 1932.

Under the assumption that for sound business reasons this merger was desirable, was the financial plan for effecting the acquisition of the Russ Manufacturing Company equitable to stockholders of both companies?

Exhibit 1
Bastian-Blessing Company
Balance Sheet, as of November 30

Item	1926	1927	1928	1929	1930	1931
Assets						
Plant, Buildings, Machinery, etc., Less Depreciation	$ 388,725	$ 380,665	$ 415,652	$ 463,729	$ 473,688	$ 456,769
Patents	4,867	4,508	4,929	8,527	9,915	11,263
Cash	211,412	215,942	447,753	242,232	331,625	167,914
Marketable Securities	....	....	....	281,555	113,188	
Accounts and Notes Receivable (Net)	243,733	268,665	332,315	371,470	329,188	248,492
Inventories	568,018	505,264	607,203	856,005	753,339	700,677
Cash Value, Life Insurance	....	8,150	10,800	13,250	8,350	
Other Assets	9,831	198,136	9,009	15,903	....	68,235
Reacquired Stock	....	....	....	....	....	118,080*
Investments (Cost)	800	....	....	....	....	9,940
Deferred Charges	....	....	....	....	20,026	18,337
Total Assets	$1,427,386	$1,581,330	$1,827,661	$2,252,671	$2,039,319	$1,799,707
Liabilities						
Capital Stock	$ 956,574†	$ 912,500†	$ 725,000‡	$ 575,000§	$ 575,000§	$ 575,000§
Accounts Payable	52,536	48,083	99,168	104,431	25,416	24,191
Accrued Taxes, etc.	14,420	9,568	38,360	53,056	20,488	25,012
Employees' Wages and Bonus	38,914					
Dividends Payable	....	41,250	65,626	71,437	83,663	
Reserve for Federal Taxes	50,512	45,000	58,562	87,200	38,700	13,200
Appraisal Surplus	....	193,025	177,937	164,226	150,229	139,184
Paid-in Surplus	....	....	187,500	325,990	325,990	325,990
Earned Surplus	314,430	331,904	475,508	871,331	819,833	697,130
Total Liabilities	$1,427,386	$1,581,330	$1,827,661	$2,252,671	$2,039,319	$1,799,707
Current Assets	$1,023,163	$ 998,021	$1,398,071	$1,764,512	$1,535,690	$1,117,083
Current Liabilities	156,382	143,901	261,716	316,124	168,267	62,403
Working Capital	$ 866,781	$ 854,120	$1,136,355	$1,448,388	$1,367,423	$1,054,680

* 4,050 shares at cost.
† 10,000 no-par preferred; 82,500 no-par common.
‡ 4,000 no-par preferred; 105,000 no-par common.
§ 115,000 no-par shares.
Contingent liability $243,642—1931.
Source: Moody's *Industrials*.

Exhibit 2
Russ Manufacturing Company
Balance Sheet, as of September 30

Item	[illegible]	1927	1928	1929	1930	1931
Assets						
Plant, Equipment, etc., Less Depreciation	$ [illegible]	$ 524,810	$ 395,160	$ 480,207	$ 530,149	$ 508,360
Goodwill	[illegible]	46,190				
Investments	[illegible]	30,000				
Cash	[illegible]	23,740	29,568	14,155	30,948	143,966
U. S. Government Securities	[illegible]	80,000	. . .	43,939	47,000	
Notes and Accounts Receivable	[illegible]	757,472	1,171,868	1,362,682	1,570,914	1,433,605
Cash Value, Life Insurance		....	....	....	3,087	4,030
Inventories	[illegible]	316,770	272,010	395,176	475,780	413,357
Other Current Assets	[illegible]	28,543	7,999	24,800		
Sinking Fund		....	102,951	4,495	7,138	5,935
Deferred Charges	[illegible]	33,679	33,251	42,782	28,446	25,174
Due on Stock Subscriptions	[illegible]	49,330	56,332	41,732		
Total Assets	$[illegible]	$1,890,534	$2,069,139	$2,409,968	$2,693,462	$2,534,427
Liabilities						
Preferred Stock		....	....	$ 888,300	$ 888,300	$ 826,700
Class A and Common Stock	$ [illegible]	$ 974,400*	$ 974,400*	245,227†	245,236†	245,235†
Bonded Debt	[illegible]	382,500	233,400	122,800	100,800	35,800
Customer Balances		7,284	....	7,623		
Accounts Payable	[illegible]	30,008	85,029	85,916	127,449	57,132
Accrued Liabilities	[illegible]	66,700	....	36,467		18,723
Dividends Payable		....	....	....	15,545	14,467
Notes Payable		100,000	255,000	342,661	605,000	575,000
Gold Notes Due		....	....	....	....	34,500
Federal Taxes	[illegible]	9,763	43,003	33,474		
Profit and Loss Surplus	[illegible]	319,879	478,307	647,500	711,132	726,870
Total Liabilities	$[illegible]	$1,890,534	$2,069,139	$2,409,968	$2,693,462	$2,534,427
Current Assets	$[illegible]	$1,206,525	$1,481,445	$1,840,752	$2,127,729	$1,994,958
Current Liabilities	[illegible]	213,755	383,032	506,141	747,994	699,822
Working Capital	$[illegible]	$ 992,770	$1,098,413	$1,334,611	$1,379,735	$1,295,136

* $100-par common.
† 8,733 shares of no-par Class A; 12,000 shares of no-par common.
Source: Moody's *Industrials*.

EXHIBIT 3
BASTIAN-BLESSING COMPANY
INCOME ACCOUNT, YEARS ENDED NOVEMBER 30

Item	1926	1927	1928	1929	1930	1931
Net earnings*	$485,480	$387,302	$479,183	$757,521	$302,599	$ 72,972
Other income	2,386	6,557	14,478	19,004	23,993	12,036
Total income	$487,866	$393,859	$493,661	$776,525	$326,592	$ 85,008
Federal taxes	67,656	45,000	59,000	87,200	38,700	13,200
Miscellaneous charges	5,998	47,157				
Net income	$414,212	$301,702	$434,661	$680,325	$287,892	$ 71,808
Dividends	70,000†	70,000†	40,000†	Not stated	Not stated	194,513
Surplus	$344,212	$231,702	$394,661	......	......	$122,705[d]
Earned per share common	$ 4.17	$ 2.81	$ 3.76	$ 5.99	$ 2.50	$ 0.62
Number of common shares	82,500	82,500	105,000	115,000	115,000	115,000
Earned per share preferred‡	$ 41.42	$ 30.17	$108.67			
Number of preferred shares	10,000	10,000	4,000			

* After depreciation.
† Preferred dividends.
‡ All outstanding preferred retired or converted into common stock in 1929.
[d] Deficit.
Source: Moody's *Industrials*.

EXHIBIT 4
RUSS MANUFACTURING COMPANY
INCOME ACCOUNT, YEARS ENDED SEPTEMBER 30

Item	1926	1927	1928	1929	1930	1931
Net sales	$1,475,552	$1,509,725	$1,923,571	$1,849,853	$2,652,036	
Operating expenses	1,304,341	1,423,050	1,642,223	1,638,912	2,273,673	
Depreciation	....	28,984	25,269	27,767	....	$ 44,098
Net earnings	$ 171,211	$ 57,691	$ 256,079	$ 183,174	$ 378,363	$155,819
Other income	28,180	52,022	45,414	81,806	80,463	
Total income	$ 199,391	$ 109,713	$ 301,493	$ 264,980	$ 458,826	$155,819
Interest charges, etc.	62,672	44,519	48,239	67,788	170,900	41,511
Federal taxes	19,857	10,412	30,000	28,000	36,200	11,000
Balance	$ 116,862	$ 54,782	$ 223,254	$ 169,192	$ 251,726	$103,308
Preferred dividends	} 42,521				62,182	44,555
Class A dividends		57,999	....	....	50,912	45,848
Surplus	$ 74,341	$ 3,217[d]	$ 223,254	$ 169,192	$ 138,632	$ 12,905
Earned per share:						
1st preferred	....	....	....	$19.05	$28 34	$12.50
Earned per share:						
Class A	....	....	....	$12.25	$21.70	$ 5.20
Earned per share—common	....	....	....	$ 3.82	$11.55	0
Number preferred shares	....	....	....	8,883	8,883	8,267
Number Class A shares	....	....	....	8,733	8,733	8,733
Number common shares	9,430	9,774	9,774	12,000	12,000	12,000

[d] Deficit.
Source: Moody's *Industrials*.

Exhibit 5
Description of Stock Issues

Bastian-Blessing Company
$6 Cumulative Preferred Stock

Par value.......	No par
Authorized.... .	3,180 shares; outstanding 3,180 shares; issued 1932
Preference......	To assets and cumulative dividends of $6 per annum payable quarterly January 1, etc.
Callability......	Callable in whole or in part on 30 days' notice on any dividend date, at $90 a share, plus accrued dividends, prior to January 1, 1934; thereafter increasing $1 a share yearly until a maximum of $100 a share is reached
Sinking fund....	A sum equal to 5% of net profits during preceding fiscal year shall be set aside yearly December 30 and applied to purchase or redemption of preferred stock not later than the next dividend date at not exceeding the then redemption price
Restrictions.....	No additional stock of this class may be issued at less than the redemption price and no stock having priority shall be issued without consent of three-fourths of the preferred stockholders
Voting power...	None

Russ Soda Fountain Company
$6 Cumulative Preferred Stock

Par value.......	No par
Authorized.....	4,770 shares; outstanding 4,770 shares; issued 1932
Preference......	As to assets and cumulative dividends
Callability......	Callable until October 1, 1932, at $75; thereafter at $90, and increasing $1 each January 1, beginning January 1, 1934, until $100 is reached

Russ Manufacturing Company
7% Cumulative First Preferred Stock

Par value... ...	$100
Authorized.....	8,883 shares; outstanding 8,267 shares on September 30, 1931; issued 1929
Purpose........	Issued to major stockholders of company in exchange for their holdings of old common stock, consisting of $974,400
Preference......	To assets and cumulative dividends of $7 per annum, payable quarterly January 1, etc.
Callability......	At par prior to October 1, 1932, and at $105 thereafter, plus accrued dividends in each case
Dividends......	Initial dividend of 1¾% paid January 1, 1930, and regularly thereafter to July 1, 1931, inclusive, after which stopped

Russ Manufacturing Company
$7 Cumulative Class A Stock

Par value.......	No par
Authorized......	8,733 shares; outstanding 8,733 shares on September 30, 1931; issued 1929
Purpose........	Issued to acquire minority interests and for stock of Siren Mills Corp.
Callability......	After all first preferred stock shall have been redeemed or retired, Class A becomes callable on any dividend date at 100
Dividends......	Initial dividend of $2.33 (covering 4 months' period) paid February 1, 1930, and $1.75 paid quarterly thereafter to May 1, 1931, inclusive, after which stopped

Sources: *Standard Corporation Records*, 1933; Moody's *Industrials;* Chicago Stock Exchange listing application.

EXHIBIT 6
BASTIAN-BLESSING COMPANY
PRICE RANGE OF THE COMMON STOCK

Year	High	Low	Year	High	Low	Year	High	Low	Year	High	Low
1927......	28¾	23	1931:			1931			1932:		
			Jan...	21½	20	July...	15¼	14½	Jan...	7¾	6½
1928......	50	24	Feb...	24	21	Aug...	15	14	Feb...	8	5
			Mar...	22	21½	Sept.	13	9½	Mar...	5½	5
1929......	62	34	Apr...	20	20	Oct...	10½	9½	Apr...	5	5
			May...	17½	15	Nov...	11	9¼	May...	4¾	2
1930......	46½	21	June...	17	14	Dec..	9	6	June...	4¼	2¼

Source: *Bank and Quotation Record.*

4. REMINGTON RAND, INC.[1]

CONSOLIDATION OF OFFICE EQUIPMENT COMPANIES

In the expectation that a consolidation would result in lower costs and increased operating efficiency, the directors of the Remington Typewriter Company, the Rand Kardex Bureau, Inc., and the Dalton Adding Machine Company decided in January, 1927, that a new company, to be known as Remington Rand, Inc., be organized to acquire all the stocks of the three companies. The terms upon which the exchange of stocks should be made remained to be determined.

The Remington Typewriter Company was the result of a merger of several small and long-established typewriter manufacturing concerns. Its capitalization, as of December 31, 1926, including subsidiary companies, was as follows:

7% cumulative first preferred stock:		
Authorized	69,250 shares	$3,998,000
Issued	39,980 shares	
8% cumulative second preferred stock:		
Authorized	60,000 shares	4,994,000
Issued	49,940 shares	
Common stock:		
Authorized	100,000 shares	9,996,000
Issued	99,960 shares	

The Remington Typewriter Company manufactured and distributed typewriters of practically every description, including, in addition to the usual standard models, noiseless, portable, electrical, tabulating, and bookkeeping typewriters of many models. It had about 1,000 sales rooms distributed throughout the world. The Remington Typewriter Company was the owner of all the outstanding stock of 22 subsidiary companies which were, in general, selling organizations incorporated under the laws of the countries in which they operated. These subsidiaries included companies in all the principal countries of the world. The company's balance sheet, as of December 31, 1926, is shown in Exhibit 1, and its income account in Exhibit 2.

The Rand Kardex Bureau, Inc., was organized in 1925 to acquire the outstanding stocks of the Rand Kardex Company,

[1] Reprinted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

EXHIBIT 1

REMINGTON TYPEWRITER COMPANY, RAND KARDEX BUREAU, INC., AND DALTON ADDING MACHINE COMPANY

BALANCE SHEETS, AS OF DECEMBER 31, 1926

Item	Remington Typewriter Company	Rand Kardex Bureau, Inc.	Dalton Adding Machine Company	Total
ASSETS				
Cash	$ 1,392,505	$ 2,008,576	$ 96,864	$ 3,497,945
United States Liberty Bonds	....	....	51,000	51,000
Notes Receivable, Less Reserve	33,600	5,323	11,585	50,508
Accounts Receivable, Less Reserve	6,206,768	5,647,212	1,435,913	13,289,893
Inventories—Lower of Cost or Market	6,437,784	5,021,660	1,262,155	12,721,599
Investments in and Advances to Affiliated Companies	765,717	380,434	....	1,146,151
Globe Wernicke Company	....	937,040	....	937,040
Miscellaneous Stocks and Bonds	151,465	12,828	....	164,293
Cash in Hands of Bond Trustees	....	172,120	64,093	236,213
Deferred Charges	102,226	510,862	122,627	735,715
Plant and Equipment, Less Reserve	3,040,927	6,278,471	2,039,874	11,359,272
Goodwill, Patents, and Trade-marks	14,023,555	1	805,412	14,828,968
Development and Experimental Expense	....	....	377,760	377,760
Total Assets	$32,154,547	$20,974,527	$6,267,283	$59,396,357
LIABILITIES				
Notes Payable to Banks	....	....	$ 100,000	$ 100,000
Trade Accounts Payable	$ 685,687	$ 710,760	34,929	1,431,376
Accrued Payroll	456,465	35,798	150,339	642,602
Accrued Taxes and Interest	185,521	192,232	19,323	397,076
Reserve for Federal Taxes	1,117,951	410,599	20,677	1,549,227
Dividends Accrued	170,000	384,837	46,066	600,903
Due to Affiliated Companies	2,990	808,117	....	811,107
Reserves	2,073,316	326,470	196,884	2,596,670
Funded Debt	....	2,050,200	1,340,000	3,390,200
Sinking Fund Reserves	....	....	59,293	59,293
Minority Interest in Subsidiary Companies	....	19,817	....	19,817
Capital Stock	18,988,000	14,409,900	3,385,300	36,783,200
Surplus	8,474,617	1,625,797	914,472	11,014,886
Total Liabilities	$32,154,547	$20,974,527	$6,267,283	$59,396,357

EXHIBIT 2

REMINGTON TYPEWRITER COMPANY

INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1923	1924	1925	1926
Net operating earnings	Not stated	Not stated	$3,221,094	$3,498,651
Depreciation	....	....	426,523	461,306
Net income	$1,678,658	$1,754,746	$2,794,571	$3,037,345
Fixed charges	75,840	56,072		
Federal taxes	....	....	425,000	440,000
Balance	$1,602,818	$1,698,674	$2,369,571	$2,597,345
First preferred dividends	810,100	354,001	354,394	322,476
Second preferred dividends	99,798	598,788	1,197,576	400,000
Surplus for common	$ 692,920	$ 745,885	$ 817,601	$1,874,869

Inc., and Library Bureau, Inc. Its capitalization, as of December 31, 1926, was as follows:

5-year 5½% gold notes due January 1, 1931		$ 2,050,200
Class A cumulative 7% preferred stock:		
Authorized	100,000 shares	4,620,000
Outstanding	46,202 shares	
Class A common stock no par value (including surplus):		
Authorized	2,000,000 shares	11,365,697
Outstanding	412,783 shares	
Class B common stock:		
Authorized	50,000 shares	50,000
Outstanding	50,000 shares	

The Rand Kardex Bureau, Inc., was the principal manufacturer and distributor of over 4,000 filing, record-keeping, and record-protecting devices. Its products included modern visible filing equipment, steel and wood filing cabinets, office furniture, indexing systems, safes and safe cabinets, guides, folders, and filing supplies. More than 1,000,000 customers, including practically every type of business or organization where systematic records were required, were served through about 500 branch offices located throughout the United States and in many foreign countries. About 60% of sales consisted of repeat orders. The company's balance sheet as of December 31, 1926, is shown in Exhibit 1; Exhibit 3 shows its income accounts over a period of years.

EXHIBIT 3
RAND KARDEX BUREAU, INC.
INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1923	1924	1925*	1926†	1926‡
Net sales	$13,597,423	$15,415,240	$12,448,197	$10,641,737	$11,836,193
Cost of sales	7,074,646	7,739,635	5,603,618	5,349,575	9,525,976
Operating expenses	5,106,245	6,126,228	4,966,326	3,407,499	
Depreciation	198,144	184,147	155,639	225,670	274,398
Net operating income	$ 1,218,388	$ 1,365,230	$ 1,722,614	$ 1,658,993	$ 2,035,819
Other income	209,428	211,723	224,802	373,059	
Total income	$ 1,427,816	$ 1,576,953	$ 1,947,416	$ 2,032,052	$ 2,035,819
Interest	64,716	42,202	36,956	72,289	75,872
Other deductions	107,442	149,931	110,827	192,585	
Federal taxes	134,058	167,995	228,883	250,000	250,000
Balance	$ 1,121,600	$ 1,216,825	$ 1,570,750	$ 1,517,178	$ 1,709,947
Dividends	445,020	532,644	552,608	657,927	1,147,376
Surplus	$ 676,580	$ 684,181	$ 1,018,142	$ 859,251	$ 562,571

* Nine months ended September 30.
† Six months ended March 31.
‡ Six months ended September 30.

The company had contracted to purchase the assets of the Baker-Vawter Company for 21,453 shares of Class A preferred stock of the Rand Kardex Bureau, Inc. The Baker-Vawter Company was incorporated in 1916; on December 31, 1926, its capitalization was as follows:

6% first mortgage gold bonds		$1,000,000
Preferred stock:		
Authorized	10,000 shares	805,300
Outstanding	8,053 shares	
Common stock no par value (including surplus):		
Authorized	100,000 shares	1,671,352
Outstanding	40,178 shares	

The Baker-Vawter Company was the originator and the world's largest manufacturer of loose-leaf ledgers. Exhibit 4 shows its balance sheets for December 31, 1925 and 1926; Exhibit 5 shows its income accounts for 1924 and 1925.

EXHIBIT 4
BAKER-VAWTER COMPANY
BALANCE SHEET, AS OF DECEMBER 31

Item	1925	1926
ASSETS		
Real Estate, Plant, and Equipment	$1,709,353	$2,125,777
Goodwill and Patents	267,708	
Investments	51,720	105,839
U. S. Government Securities	25,000	
Inventories	655,375	723,334
Cash	210,918	134,013
Bills Receivable	113,500	72,324
Accounts Receivable	405,922	381,100
Other Assets	34,437	
Deferred Charges	19,852	82,416
Total Assets	$3,493,785	$3,624,803
LIABILITIES		
Preferred Stock	$ 386,200	$ 805,300
Common Stock	1,912,100	1,671,352
Surplus	222,800	
Bonded Debt	....	1,000,000
Accounts Payable	28,641	46,313
Interest and Wages Accrued	39,811	101,838
Reserve for Taxes	31,525	
Depreciation Reserve	865,242	
Other Reserves	7,466	
Total Liabilities	$3,493,785	$3,624,803

EXHIBIT 5
BAKER-VAWTER COMPANY
INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1924	1925
Sales	$2,492,638	$2,679,823
Cost of sales	2,296,016	2,403,561
Depreciation	81,027	84,561
Net earnings	$ 115,595	$ 191,701
Other income	91,310	50,900
Total income	$ 206,905	$ 242,601
Miscellaneous charges	4,680	5,995
Federal taxes	23,048	30,325
Balance	$ 179,177	$ 206,281
Preferred dividends	42,891	26,905
Common dividends	131,753	115,076
Surplus	$ 4,533	$ 64,300

The Dalton Adding Machine Company, incorporated in Ohio in 1914, succeeded a business originally incorporated in 1902. Its capitalization as of December 31, 1926, was as follows:

15-year 6% sinking fund gold notes		$1,340,000
Preferred stock $100 par value:		
Authorized	7,500 shares	750,000
Issued	7,500 shares	
Common stock $100 par value:		
Authorized	92,500 shares	2,635,300
Issued	26,353 shares	

The Dalton Adding Machine Company manufactured and distributed about 150 models of calculating machines including ledger, posting, and statement machines which were used extensively by banks, insurance companies, and other businesses requiring numerous computations. The Dalton Adding Machine Company had two subsidiaries, one a domestic sales subsidiary and the other a Canadian corporation manufacturing and selling the company's products in Canada. The company's balance sheet as of December 31, 1926, is shown in Exhibit 1, while Exhibit 6 shows its income accounts.

These companies were each of major importance in noncompetitive but closely allied lines, and their consolidation would bring together under unified control the manufacture and dis-

tribution of a complete line of office appliances and equipment. In 1923, according to the United States Census of Manufactures, the office equipment industry had sales of approximately $400,000,000, an increase of about 225% over 1914. With the continued growth of large-scale industry the making and preserving of business records was expected to become of increasing importance.

EXHIBIT 6
DALTON ADDING MACHINE COMPANY
INCOME ACCOUNT, YEARS ENDED DECEMBER 31, 1925, AND APRIL 30, 1926

Item	December 31, 1925	April 30, 1926
Gross revenue	$3,496,825	$3,628,476
Operating expenses	3,030,447	3,106,783
Depreciation	77,303	80,303
Net revenue	$ 389,075	$ 441,390
Other income	17,535	18,965
Total income	$ 406,610	$ 460,355
Fixed charges	125,082	135,149
Federal taxes	27,600	42,000
Balance	$ 253,928	$ 283,206
Preferred dividends	52,500	52,500
Common dividends	32,934	65,869
Surplus	$ 168,494	$ 164,837

The new company through its subsidiaries would have the largest international distributing organization in the world. It would centralize research work in perfecting existing apparatus and developing new equipment and would eliminate duplication of sales and administrative forces. Since each company had a separate sales office and warehouse in a large number of the same cities, the new company planned to effect economies by utilizing one sales office and warehouse in each city. Remington Rand, Inc., would centralize all related processes and bring 37 manufacturing plants under a single directing head. Exhibit 7 shows the consolidated statement of earnings of the Remington Typewriter Company, Rand Kardex Bureau, Inc., and the Dalton Adding Machine Company for the 5 years ending December 31, 1926.

The demand for office appliances and equipment was stable. During periods of prosperity business concerns added to their

existing equipment and purchased new and advanced models; during periods of depression the importance of reducing overhead expenses was emphasized, and appliances were purchased to effect necessary economies. Replacements were always an important factor in estimating sales; for records and machines depreciated rapidly, and improved machines rendered the older models obsolete. American manufacturers had been the leaders in developing foreign markets for office appliances and equipment. Although from 20 to 30% of the business of the leading manufacturers was in the export field, this market was far less developed than the domestic field.

EXHIBIT 7

REMINGTON TYPEWRITER COMPANY, RAND KARDEX BUREAU, INC., AND DALTON ADDING MACHINE COMPANY

CONSOLIDATED STATEMENT OF EARNINGS, YEARS ENDED DECEMBER 31

Year	Profit before interest, depreciation, and Federal taxes	Interest	Depreciation	Federal taxes	Net profit
1922	$2,293,649	$221,372	$ 592,810	$ 44,518	$1,434,949
1923	4,173,454	207,267	679,480	353,945	2,932,762
1924	4,437,571	167,687	669,211	466,199	3,134,474
1925	6,820,406	147,149	772,299	950,618	4,950,340
1926	8,108,637	228,308	1,008,005	978,768	5,893,556

1. Was the Remington Rand, Inc., consolidation economically sound?

2. Upon what basis should the exchange of securities have taken place?

5. STUDEBAKER CORPORATION

PROPOSED ACQUISITION OF WHITE MOTOR COMPANY BY PURCHASE OF COMMON STOCK

In September, 1932, the directors of the Studebaker Corporation voted to submit an offer to the White Motor Company for all the common stock of the latter company. Under the plan proposed, the identity of the White Motor Company would be maintained, and the Studebaker Corporation, together with its subsidiaries, the Pierce-Arrow Motor Car Company and the Rockne Motors Corporation, would continue to operate as units under these names. The directors of the White Motor Company subsequently approved the offer, subject to the assent of three-fourths of the outstanding stock, and requested their stockholders to make the plan effective by depositing their shares by October 18, 1932.

The advantages expected from the proposed purchase as outlined by the directors of the Studebaker Corporation and the White Motor Company were as follows: (1) economies in the purchase of materials; (2) a broader distribution of their products, especially of White trucks and busses; and (3) a more inclusive line of motor vehicles for commercial and industrial use.

Incorporated in 1911 to take over Studebaker Brothers Manufacturing Company, a pioneer vehicle business founded in 1852, Studebaker Corporation became one of the leading producers of motor cars. The acquisition of a controlling interest in the Pierce-Arrow Motor Car Company in 1928 and the introduction of the Rockne car in November, 1931, gave the company a line of motor cars ranging in price from $585 to $10,000. In addition to passenger cars, which were its major product, the company also was an important manufacturer of ambulances, funeral cars, and light delivery cars. Its subsidiary, the Pierce-Arrow Motor Car Company, manufactured both passenger cars and heavy-duty trucks. Through its ownership of 51% of the Free Wheeling Corporation, the Studebaker Corporation controlled patents on free wheeling, a device first developed and used by this company.

Plants manufacturing Rockne and Studebaker products were located in South Bend, Indiana, and Detroit, Michigan; Pierce-Arrow passenger cars and trucks were produced in Buffalo, New York. Regional warehousing of cars, parts, and accessories

was undertaken in 1932 by the formation of the Studebaker Pierce-Arrow Rockne Sales Corporation in order to improve the service rendered by some 1,800 independent dealers and distributors who handled the sales of the Studebaker organization in the United States. In 1930 another subsidiary, the S. P. A. Truck Corporation, was formed to take over the manufacture and sale of all Pierce-Arrow and Studebaker commercial cars.

In contrast to the Studebaker Corporation with its volume production in passenger cars, the White Motor Company, incorporated in 1915, had manufactured commercial vehicles exclusively since 1917. In January, 1932, the White Motor Company had purchased the physical assets of the Indiana Motors Corporation which manufactured and sold assembled motor trucks ranging in capacity from 1 to 7½ tons. Although heavy-duty trucks and busses were its principal products, the White Motor Company also manufactured fire apparatus, police patrols, ambulances, armored cars, and other types of trucks. Sales of new equipment and repair parts to large organizations constituted the most important part of the company's business.

Located in Cleveland, Ohio, the plant of the White Motor Company had a capacity of 1,500 trucks and busses per month and could supply parts for the servicing of trucks already in operation. The plant of the Indiana Motors Corporation was situated in Marion, Indiana. Unlike the Studebaker Corporation, which distributed its products through independent dealers, the White Motor Company through subsidiary companies controlled 76 factory branches and service stations, which distributed 75% of the total output; 600 dealers handled the remainder of the sales.

The terms of the proposed offer provided that $5 cash, $25 in 6% two-year notes of the Studebaker Corporation, and one share of Studebaker common be exchanged for each share of the outstanding common stock of the White Motor Company. The notes were payable on or before two years from date of issuance, but the Studebaker Corporation retained the option, during the first year of issuance, to substitute for such notes an eight-year note of the same tenor and substance exchangeable into common stock of the Studebaker Corporation at any time during the eight-year period. The basis of the exchange would be one share of Studebaker common for each $25 of principal of the notes. If the company did not elect to substitute the eight-year notes,

or if the owners of 75% of the notes failed to ask the trustee not to declare the notes due on December 1, 1934, that date was to be regarded as the maturity of the notes. The indenture provided that so long as any of the notes were outstanding, the corporation could not, except with the consent in writing of the bearers or registered owners of 66⅔% of the notes then outstanding, incur a mortgage or other lien upon any of its real estate or fixed assets or upon any stocks, bonds, or other securities of any subsidiary. Likewise, subsidiary companies could not create a mortgage or lien (other than mortgages or liens in favor of the corporation and retained by it) upon any of the real estate or personal property of these subsidiaries.

1. Appraise the reasons for the proposed acquisition of the White Motor Company as stated by the directors of both companies.

2. Study the financial exhibits for indications of motives which were not mentioned.

3. Was the plan proposed for acquiring the White Motor Company stock equitable to (*a*) Studebaker Corporation stockholders; (*b*) White Motor Company stockholders?

4. Was the proposed plan for financing the acquisition of the White Motor Company sound?

5. Would the Studebaker Corporation have improved its financial condition by acquiring the White Motor Company under the proposed plan?

EXHIBIT 1
STUDEBAKER CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

Item	Dec. 31 1928	Dec. 31 1929	Dec. 31 1930	Dec. 31 1931	June 30 1932	Sept. 30 1932
ASSETS						
Current Assets:						
Cash	$ 13,466,401	$ 5,113,307	$ 7,851,963	$ 9,931,794	$ 5,064,841	$ 4,684,341
Acceptances and Receivables, Less Reserves	6,277,117	4,506,021	3,638,497	3,988,267	2,797,753	3,503,650
Investments	3 223,158	325,060	80,702	70,756	75,096	73,793
Inventories and Deferred Charges	28,574,177	26,637,794	18,168,843	16,941,517	14,449,455	12,541,176
Total Current Assets	$ 51,540,853	$ 36,582,182	$ 29,740,005	$ 30,932,334	$22,387,145	$20,802,960
Miscellaneous Real Estate (Including Sales Contracts)*	15,305,291	14,970,397	11,409,333	11,596,626	3,517,050	3,488,071
Company's Stock (Including Held for Employees)	3,182,405	3,770,444	936,284	7,917	.....	5,330
Investments in and Advances to Other Companies	.....	.....	284,947	274,403	470,086	318,873
Manufacturing Plant*	57,841,734	59,077,022	57,726,050	55,667,890	47,879,892	47,637,438
Goodwill, Patents, Trade-marks	20,743,084	19,807,278	19,807,278	19,807,278	2	2
Total Assets	$148,613,367	$134,207,323	$119,903,897	$118,286,448	$74,254,175	$72,252,674
LIABILITIES						
Current Liabilities:						
Notes Payable	.....	$ 1,400,000	$ 5,000,000	$ 5,500,000	$ 5,500,000	$ 6,100,000
Accounts and Deposits Payable	$ 10,976,036	5,441,099	3,741,868	6,222,365	2,286,037	1,819,459
Sundry Creditors and Reserves	5,117,009	3,146,626	1,844,437	1,921,388	1,641,526	1,726,098
Total Current Liabilities	$ 16,093,045	$ 9,987,725	$ 10,586,305	$ 13,643,753	$ 9,427,563	$ 9,645,557
Debentures and Purchase Money Obligations	3,113,200	346,000	332,500	355,875	342,000	333,750
Minority Interest: Pierce-Arrow 6 % Preferred	8,000,000	7,500,000	7,150,000	5,600,000	5,111,320	5,102,820
Pierce-Arrow Class A	456,083	387,510	370,797	209,283		
Preferred Stock, 7 % Cumulative	7,300,000	6,970,000	6,750,000	6,300,000	5,916,200	5,916,200
Common Stock	75,000,000	78,454,320	76,201,800	76,201,800	38,046,900	37,882,900
Reserve for Detroit Plant Liquidation	1,970,000					
Surplus	36,681,039	30,561,768	18,512,495	15,975,737	13,116,568	11,077,823
Capital Surplus	.....	.....	.....	.....	2,293,624	2,293,624
Total Liabilities	$148,613,367	$134,207,323	$119,903,897	$118,286,448	$74,254,175	$72,252,674

* After depreciation.
Sources: Company reports; *Commercial and Financial Chronicle.*

Exhibit 2
Studebaker Corporation and Subsidiaries
Consolidated Income and Surplus Accounts

Item	[illegible]	[illegible]	[illegible] 31	Dec. 31 1931	Jan.–June, 1931, 6 months	Jan.–Sept., 1932, 9 months
Number of vehicles sold	[illegible]	[illegible]	67,269	58,202	. . .	40,481†
Net sales, in United States and abroad	[illegible]	[illegible]	[illegible]	$64,406,858	$31,468,838	$39,611,397
Operating and selling costs	[illegible]	[illegible]	[illegible]	$57,760,823	$31,108,612	$40,596,063
Repairs and replacements	[illegible]	[illegible]	[illegible]	3,643,374	1,632,836	1,878,807
Depreciation	[illegible]	[illegible]	[illegible]	2,251,587	1,095,070	1,493,295
Total cost of sales	[illegible]	[illegible]	[illegible]	$63,655,784	$33,836,518	$43,968,165
Operating income	[illegible]	[illegible]	[illegible]	$ 751,074	$ 2,367,680[d]	$ 4,356,768[d]
Other income	[illegible]	[illegible]	[illegible]	81,327	108,483[d]	153,056[d]
Total	[illegible]	[illegible]	[illegible]	$ 832,401	$ 2,476,163[d]	$ 4,509,824[d]
Deductions, including tax reserve	[illegible]	[illegible]	9,978	7,199	859	1,112
Net profits	[illegible]	[illegible]	[illegible]	$ 825,202	$ 2,477,022[d]	$ 4,510,936[d]
Less:						
Dividends on Pierce-Arrow preferred		[illegible]				
Minority interest, Pierce-Arrow Class A	[illegible]	[illegible]	[illegible]	34,603*	75,882*	120,398*
Dividends on Studebaker preferred	[illegible]	[illegible]	[illegible]	460,250	220,500	324,033
Total	[illegible]	[illegible]	[illegible]	$ 425,647	$ 144,618	$ 203,635
Net profit for year	[illegible]	[illegible]	[illegible]	399,555	2,621,640[d]	4,714,571[d]
Surplus, January 1	[illegible]	[illegible]	[illegible]	18,512,495	15,975,737	15,975,737
Total	[illegible]	[illegible]	[illegible]	$18,912,050	$13,354,097	$11,261,166
Less:						
Dividends on Studebaker common	[illegible]	[illegible]	[illegible]	2,353,696	588,424	588,424
Stock dividend	[illegible]	[illegible]				
To reduce cost of investment in Pierce Arrow to book value		[illegible]				
Losses incidental to centralization	[illegible]					
Miscellaneous adjustments			[illegible]	582,617	350,895*	405,081*
Balance, surplus at end of period	[illegible]	[illegible]	[illegible]	$15,975,737	$13,116,568	$11,077,823
Capital surplus, created by adjustments	.		.....	....	$ 2,293,624	$ 2,293,624
Number of shares common	[illegible]	[illegible]	[illegible]	1,905,045	1,902,345	1,894,145
Earned per share common	[illegible]	[illegible]	$0.28	$0.21	$1 38[d]	$2.49[d]

* Credit.
† 8 months.
[d] Deficit.
Sources: Company reports; *Commercial and Financial Chronicle.*

Exhibit 3
The White Motor Company
and The White Company and The White Company, Limited (Subsidiary Companies)
Balance Sheets

Item	Dec. 31 1928	Dec. 31 1929	Dec. 31 1930	Dec. 31 1931	June 30 1932	Sept. 30 1932
Assets						
Current Assets:						
Cash	$ 1,376,907	$ 1,432,786	$ 1,255,814	$ 4,056,768	$ 5,444,092	
Securities	10,869,935	9,223,655	8,551,904	4,572,646	3,467,838	
Notes and Accounts Receivable	6,504,579	5,974,160	3,979,271	5,611,426	3,927,761	
Inventories	13,243,129	15,566,153	13,992,248	9,219,326	8,660,597	
Total Current Assets	$31,994,550	$32,196,754	$27,779,237	$23,460,166	$21,500,288	$20,487,591
Investments in Affiliated Companies	4,568,891	4,417,043	4,400,262	4,995,499	5,721,679	
Plant	9,282,018	9,634,263	9,186,566	8,545,135	8,225,601	
Goodwill, Patents, etc.	5,388,910	5,388,910	5,388,910	5,388,910	5,388,910	
Deferred Assets	455,815	489,010	455,719	388,346	239,464	
Treasury Stock, Employees' Stock Purchase Plan	....	877,027	2,447,061	....	403,752	
Total	$51,690,184	$53,003,007	$49,657,755	$42,778,056	$41,479,694	
Liabilities						
Current Liabilities:						
Accounts Payable	$ 2,689,190	$ 2,161,255	$ 1,474,049	$ 1,108,582	$ 1,041,792	
Accrued Taxes	845,496	730,269	421,468	207,928	289,538	
Subsidiary Companies	205,579	284,289	14,132	36,564	141,037	
Total Current Liabilities	$ 3,740,265	$ 3,175,813	$ 1,909,649	$ 1,353,074	$ 1,472,367	$ 1,483,647
Purchase Money Obligation	....	42,330	38,660			
Reserves	1,147,754	1,107,334	718,365	945,744	955,796	
Capital Stock, Par $50	40,000,000	40,000,000	40,000,000	32,500,000	32,500,000	
Surplus	6,802,165	8,677,530	6,991,081	7,979,238	6,551,531	
Total	$51,690,184	$53,003,007	$49,657,755	$42,778,056	$41,479,694	
Contingent Liabilities						
Guarantee of White Motor Securities Corp., Preferred Stock	$ 2,500,000	$ 2,500,000	$ 2,500,000	$ 2,500,000	No data	No data
Guarantee of Customers' Notes Sold to W.M.S. Corp	9,958,904	9,915,287	9,446,828	8,377,787	No data	No data

Sources: Company reports; *Commercial and Financial Chronicle; Standard Statistics.*

EXHIBIT 4
THE WHITE MOTOR COMPANY
(AND SUBSIDIARY COMPANIES)
PROFIT AND LOSS AND SURPLUS

Item	Dec. 31 1928	Dec 31 1929	Dec. 31 1930	Dec 31 1931	Jan.–June 1932 6 mos.
PROFIT AND LOSS ACCOUNT					
Sales	$47,540,594	$48,652,557	$36,532,702	$23,517,462	$9,843,534
Manufacturing, selling, and administrative expense				$26,076,503	
Repairs and renewals					
Depreciation				829,825	
Total cost of sales	$45,552,007	$46,184,225	$37,624,304	$26,906,328	
Operating profit	$ 1,988,587	$ 2,468,332	$ 1,091,602[d]	$ 3,388,866[d]	
Other income	250,175	429,314	618,101	153,910	
Total	$ 2,238,762	$ 2,897,646	$ 473,501[d]	$ 3,234,956[d]	
Deductions for income taxes	275,000	350,000			
Net profit	$ 1,963,762	$ 2,547,646	$ 473,501[d]	$ 3,234,956[d]	$1,427,707[d]
SURPLUS ACCOUNT					
Surplus, Jan. 1	$ 5,781,352	$ 6,802,165	$ 8,677,530	$ 6,991,081	$7,979,238
Net profit	1,963,762	2,547,646	473,501[d]	3,234,956[d]	1,427,707[d]
Adjustment of book value of subsidiaries	357,051	327,719	389,727	464,244	
Surplus arising from retirement of capital stock				4,113,619	
Total	$ 8,102,165	$ 9,677,530	$ 8,593,756	$ 8,333,988	$6,551,531
Less:					
Dividends paid	800,000	1,000,000	1,502,675	354,750	
Transferred to reserve for contingencies	500,000		100,000		
Balance, surplus at end of period	$ 6,802,165	$ 8,677,530	$ 6,991,081	$ 7,979,238	$6,551,531
Number of shares	800,000	800,000	800,000	650,000	650,000
Earned per share	$2.45	$3.18	$0 59[d]	$4.98[d]	$2 20[d]

[d] Deficit.
Sources: Company reports; *Commercial and Financial Chronicle.*

Exhibit 5
Index Numbers of Value of Studebaker Sales, White Sales, and Total Production of Passenger Cars and Trucks in United States and Canada

Year	Studebaker sales	White sales	Total production
1928	100	100	100
1929	82	103	113
1930	49	77	67
1931	36	48	45
1932	26*	38*	25

* Estimated from figures for first six months
Sources: Computed from company reports, and from *Facts and Figures of the Automotive Industry.*

Exhibit 6
Price Range of the Common Stock

Date	Studebaker		White	
	High	Low	High	Low
1932:				
Jan	13¼	10¼	10¼	8½
Feb	11⅞	10¼	10⅞	8⅝
Mar	11¼	7¼	12	10
Apr	7⅜	4¼	10	7¾
May	5	2½	8¼	7
June	4	2⅞	8¾	6⅞
July	5	3⅛	10¾	7
Aug	8¾	4¾	15¾	9¼
Sept	13¾	7¼	27¼	15

Source: *Commercial and Financial Chronicle.*

6. PIERCE-ARROW MOTOR CAR COMPANY (II)

PURCHASE OF CONTROLLING INTEREST IN MOTOR CAR COMPANY

On August 26, 1933, it was announced that a group of investors of New York, Boston, and Buffalo had purchased from the Studebaker Corporation, then in receivership, its controlling interest in the Pierce-Arrow Motor Car Company, and that the latter company would thereafter "operate as an independent unit in the fine-car field."

The company was incorporated in New York in August, 1926, as a consolidation of the Pierce-Arrow Motor Car Company and the P. A. S. Motor Corporation. At the same time the Studebaker Corporation assumed control of the consolidated company by acquiring, for $2,000,000, the entire issue (230,125 shares) of its Class B stock. In March, 1933, the former company was placed in receivership. About five months later the receivers of the Studebaker Corporation, in order to "concentrate their efforts and funds in the development of the Studebaker business . . . and to be relieved of the responsibility of financing" the Pierce-Arrow Motor Car Company, decided to sell Studebaker's entire holdings of Pierce-Arrow stock to the group of investors mentioned above.

The Pierce-Arrow Motor Car Company manufactured eight-cylinder and twelve-cylinder automobiles in a plant covering 45 acres in Buffalo, New York. In August, 1933, the president of the company stated that this plant was "self-adequate, from the manufacture of engines through to the construction of bodies," and that more than $2,000,000 had been spent in improving it since January, 1930.

During the period from 1928 to August, 1933, the company's annual output of cars was as follows: 1928, 5,492; 1929, 9,840, 1930, 6,916; 1931, 4,210; 1932, 2,241; 1933 (first six months), 1,020. Though the production of Pierce-Arrow cars for 1932 and the first half of the following year declined to a rate approximately 50% below that for 1931, the outlook in August, 1933, appeared to be more favorable, as is indicated by the following extracts from a statement of the president of the company:

. . . . . .

Pierce-Arrow sales this summer have been twice as good as last year. Assuming that the period of recovery has been entered, there is

every reason to believe that there will be a large replacement of cars in our class during the next two or three years, and that Pierce-Arrow will enjoy a good part of this increased demand.

Since 1928 our share of sales in the fine-car field has been doubled.

. . . . . .

Operations of your company and subsidiaries for the quarter ending June 30, 1933, show net profits of $4,770. This compares with a net loss of $878,800 for the corresponding quarter of 1932. For the first six months of 1933, net losses were $254,735 against net losses of $1,072,334 for the same period in 1932. The entire loss for the first six months of 1933 occurred in the first quarter, when economic conditions were at their worst and automobile buying had receded to extremely low levels.

Results of the company's program of expense curtailment and control, which involved readjustment of organization and layout, are evidenced by the following comparative figures:

Date	Sales	Profit or loss
1932:		
Second quarter........	$1,598,884	$878,800* loss
1933:		
Second quarter........	1,555,642	4,770 profit

* Includes $178,000 of nonrecurring losses.

On the basis of July costs and selling prices, my calculations show that a slight profit after depreciation but before interest and income taxes would accrue on annual sales of 3,000 cars of the present line. On a similar basis, the sale of 4,000 cars annually would result in profits of somewhat over $1,000,000, and on the sale of 5,000 cars profits of about $1,750,000—both figures being before interest charges and income taxes. Our sales for the last 10½ years have averaged 4,980 cars annually, and for the last 5½ years 5,403 cars annually. . . .

As of June 30, 1933, the company had outstanding 71,100 shares of preferred, 197,250 shares of Class A, and 230,125 shares of Class B stock. Of these securities, the Studebaker Corporation on August 26, 1933, held 23,500 shares of preferred, 152,215 shares of Class A, and all the Class B stock. It also held a 6% note of the Pierce-Arrow Motor Car Company for $2,000,000, due in 1937, and was owed $108,187 by the latter company on open account. The purchase agreement provided that the Studebaker Corporation should exchange all its Pierce-Arrow stock for $1,000,000 in cash.

Balance sheets and operating statements of the company are shown in Exhibits 1 and 2. Provisions relating to the three classes of stock outstanding on August 26, 1933, are shown in Exhibit 3, and prices of the preferred and Class A stock for selected dates in 1933, in Exhibit 4.

Was the price paid for the Studebaker Corporation's holdings of Pierce-Arrow stock equitable to all interests concerned?

EXHIBIT 1

PIERCE-ARROW MOTOR CAR COMPANY AND SUBSIDIARY COMPANIES
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1931	1932	June 30, 1933
ASSETS			
Cash	$ 674,432.69	$ 448,102 34	$ 241,321.52
Notes and accounts receivable, less reserve	696,047.65	321,415.55	495,411.39
Inventories, including finished cars, service parts, raw materials, work in progress and supplies at plants and branches—at lower of cost or market	4,444,203.40	2,020,539.54	1,752,606.71
Total current assets	$ 5,814,683 74	$ 2,790,057.43	$ 2,489,339.62
Miscellaneous investments, etc., at cost less reserve	$ 262,401.84	$ 135,188.03	$ 152,755.79
Insurance unexpired, prepaid expenses, etc.	150,930.73	138,280.49	126,003 82
Branch house property not used in manufacturing operations	819,809 05	811,490.40	803,506.87
Land and buildings on the basis of appraisal in 1928, with subsequent additions (at cost) and machinery, equipment, etc. (at cost)	$11,320,033.26	$11,248,154.50	$11,189,419.25
Less reserve for depreciation	4,377,413.29	4,569,264 73	4,606,147.48
Total capital investments	$ 6,942,619.97	$ 6,678,889.77	$ 6,583,271 77
Goodwill, patents, and trade-marks	1.00	1 00	1.00
Total assets	$13,990,446.33	$10,553,907 12	$10,154,878 87
LIABILITIES			
Notes payable	$ 500,000.00	$ 700,000 00	$ 461,394 33*
Accounts payable	1,197,284.77	426,060 10	348,097.48
Deposits on sales contracts	58,515 35	19,287 81	14,901.73
Accrued expenses	190,273 43	204,120 12	175,938 28
Sundry creditors and reserves	37,500.00	81,451.94	89,794 89
Amount payable to preferred stockholders of old company upon surrender of shares not yet exchanged	1,420.00	1,310.00	310.00
Total current liabilities	$ 1,984,993.55	$ 1,432,229.97	$ 1,090,436.71
Due to the Studebaker Corporation:			
Current account	$ 1,638,797.59	$ 1,226.95	$ 98,039.43
6 % gold note due 1937	....	2,000,000.00	2,000,000 00
Account prior to March 18, 1933	....	....	108,187 68
Real estate purchase mortgages, maturing in October, 1934	355,875.00	333,750.00	326,250.00
6 % cumulative preferred stock—Authorized and issued, 80,000 shares of $100 each	$ 8,000,000.00	$ 8,000,000.00	$ 8,000,000.00
Less: Retired under provision of charter	890,000.00	890,000.00	890,000.00
Outstanding	$ 7,110,000.00	$ 7,110,000.00	$ 7,110,000.00
Class A stock—Authorized and issued, 197,250 shares of no par value, but of a stated value of $1 each	197,250.00	197,250.00	197,250.00
Class B stock—Authorized and issued, 230,125 shares of no par value, but of a stated value of $1 each	230,125.00	230,125.00	230,125.00
Deficit	2,473,405.19†	750,674 80	1,005,409.95
Total liabilities	$13,990,446.33	$10,553,907 12	$10,154,878.87

* Of this amount $111,394.33 represents a liability of a subsidiary selling company, secured by 33 of the finished cars, valued at $79,613.42, included in inventory, and by funds received or receivable from the sale of other cars, in the amount of $31,780.91.

† Surplus.

NOTE: Five 1½ % quarterly preferred stock dividends in arrears at June 30, 1933—$533,250.00. Contingent liability on repurchase agreement in respect of customers' notes to finance company for car sales at June 30, 1933—$575,124.39.

Sources: *Commercial and Financial Chronicle*; Moody's *Industrials*.

EXHIBIT 2
PIERCE-ARROW MOTOR CAR COMPANY
CONSOLIDATED PROFIT AND LOSS AND SURPLUS ACCOUNT, YEARS ENDED DECEMBER 31

Item	1930	1931	1932	(6 months ended June 30) 1933
Net sales	$19,016,971.94	$11,925,657 45	$ 7,988,956 00	$2,947,838 53
Deduct:				
Cost of sales, including selling, advertising, and administrative expenses and all cost of manufacturing except depreciation, repairs, and replacements to plant and property	$17,087,819.25	$11,323,263.21	$10,067,161.22	$2,864,559 45
Depreciation	239,397.84	295,959 48	245,151.76	52,446.07
Repairs and replacements	513,274.13	844,092 20	671,797 28	230,892.50
Total	$17,840,491.22	$12,463,314 89	$10,984,110.26	$3,147,898 02
Net loss on sales	$ 1,176,480.72*	$ 537,657.44	$ 2,995,154 26	$ 200,059 49
Other income—interest, discount on purchases, etc.	189,528 09	124,378.14	89,985 19	27,696.20
Net loss before interest charges, taxes, etc.	$ 1,366,008 81*	$ 413,279.30	$ 2,905,169 07	$ 172,363.29
Add: Interest on notes payable, etc.	48,938.04	63,663.92	127,260 92	82,371 86
Net loss for period	$ 1,317,070.77*	$ 476,943 22	$ 3,032,429.99	$ 254,735.15
Deficit, January 1	2,213,611.74†	3,094,038.20†	2,052,712.48†	1,086,367 51
Discount on preferred stock retired	111,980 69	11,955 00	....	...
	$ 3,642,663.20	$ 2,629,049.98	$ 979,717.51	$1,341,102.66
Dividends paid on preferred stock	$ 450,000.00	$ 428,400.00	$ 106,650.00	..
Dividends paid on Class A stock	98,625 00	147,937.50	....	.
	$ 548,625 00	$ 576,337 50	$ 106,650 00	. .
Deficit, end of period	$ 3,094,038 20†	$ 2,052,712.48†	$ 1,086,367.51	$1,341 102.66
Deduct:				
Capital surplus of old company, January 1	$ 1,092,901.19	$ 1,092,901 19	$ 420,692 71	$ 335,692.71
Less: Adjustment of book value of certain assets of the old company taken over for liquidation by present company	....	672,208 48	85,000 00	....
Capital surplus, end of period	$ 1,092,901.19	$ 420,692.71	$ 335,692 71	$ 335,692 71
Net deficit, end of period	$ 4,186,939.39†	$ 2,473,405.19†	$ 750,674.80	$1,005,409.95

* Profit.
† Surplus.
Sources. *Commercial and Financial Chronicle;* Moody's *Industrials.*

EXHIBIT 3
PIERCE-ARROW MOTOR CAR COMPANY
PROVISIONS RELATING TO CAPITAL STOCK OUTSTANDING
AS OF AUGUST 26, 1933

1. 6% cumulative preferred stock:

Preferred as to assets and dividends. In any liquidation entitled to 105 and dividends; callable as a whole or in part on any dividend date on 30 days' notice at 105.

Entitled to one vote per share on default of four quarterly dividends.

Sinking fund of $126,000 payable semiannually and cumulative from July 1, 1930, to an amount sufficient to retire all outstanding preferred at purchase or call at not exceeding the redemption price.

Without consent of two-thirds of preferred, company shall not change preferences, rights, or privileges of preferred, increase authorized amount, or create any stock having priority or on a parity herewith. Indenture contains provisions restricting creation of mortgage indebtedness of any sort maturing in more than one year by company or any subsidiary.

2. $2 noncumulative participating Class A stock:

Entitled to noncumulative dividends of $2 per share per annum before Class B. After Class B stock has received $2 per share in any year, any further distribution of dividends shall be made at a rate on the Class A stock which shall be one-half the rate on the Class B stock. In any liquidation or distribution of assets participates with Class B stock at a rate per share which shall be one-half the rate per share on Class B.

Callable as a whole or in part at any time on 30 days' notice to and including December 31, 1932, at $40 per share and at any time thereafter at $40 per share plus $2 for each full year commencing with January 1, 1932, in which net earnings equal or exceed one and one-half times the dividend requirements on Class A stock less the amount of such dividends paid on or after January 1, 1933, provided, however, redemption price shall be not less than $40 nor more than $46 per share.

Each share has one vote.

Without consent of two-thirds of Class A stock outstanding, company may not (*a*) change preferences, rights, or privileges of this stock; (*b*) increase authorized amount of either Class A or B; create, issue, change or convert any stock having preference over or on a parity with Class A and B stock.

3. Class B stock:

Each share has two votes.

(For participation in earnings and claim against assets, see provisions relating to Class A stock, above.)

Source. Moody's *Industrials*.

EXHIBIT 4

PIERCE-ARROW MOTOR CAR COMPANY

PRICES* OF 6% PREFERRED AND CLASS A STOCK FOR SELECTED DATES IN 1933†

Date	6% cumulative preferred stock		Class A stock	
	High	Low	High	Low
January 1 to August 26	21	4	10	1½
Week ending:				
June 3	18	12	7⅞	5½
10	....	...	10	8
17	19	15	7	7
24	....	....	7¼	3½
July 1	....	....	7¼	7¼
8	12	12	5	5
15	10¼	10¼	5⅞	5¼
22	....	....	7	5¼
29	....	....	5¼	5
Aug. 5	14¾	14¾	5¼	4⅞
12	13	12	5	5
19	19¼	13	6⅞	4½
26	21	16¼	7⅞	6
	Closing		Closing	
Aug. 21	18		6	
22	20		7	
23	21		7⅞	
24	19½ bid, 20 asked		7	
25	19 bid, 20 asked		6¼	
26	....		6¼	

* New York Stock Exchange.

† Prices on Class B stock not quoted, since all this stock was held by the Studebaker Corporation.

Sources: *Commercial and Financial Chronicle; Bank and Quotation Record.*

VIII

RECAPITALIZATION AND REORGANIZATION

1. ARMOUR AND COMPANY (ILLINOIS)

READJUSTMENT OF CAPITAL STRUCTURE

On May 28, 1934, the directors of Armour and Company approved, for subsequent presentation to the stockholders, a plan for readjustment of the capital structure of their company. Since the summer of 1933 the management had proposed two other plans for effecting a recapitalization, but insufficient support from stockholders prevented the adoption of either plan.

The three recapitalization plans proposed successively by the directors of Armour and Company were summarized as follows:

SUMMARY OF PLAN I

(June 9, 1933)

Under the first plan, present shares of capital stock were to be exchanged for 4,418,588 shares of new common stock and for rights to

Present security	Present shares now outstanding	New securities to be outstanding capital stock		
		Initial issue		Shares of common stock after exercise of warrants
		Shares of common stock	Stock purchase warrants	
Preferred stock	571,703	4,001,921	....	4,001,921
Class A common stock	2,000,000	250,000	3,000,000	3,250,000
Class B common stock	2,000,000	166,667	2,000,000	2,166,667
Total	4,571,703	4,418,588	5,000,000	9,418,588

purchase an additional 5,000,000 shares. Of the 5,000,000 shares 3,333,334 were to be sold for $12.50 a share and 1,666,666 were to be sold for $15 within five years. The stock was to be distributed as follows:

1. The preferred stockholders to receive seven shares of new common stock for each share held and for the accumulated dividends of $17.50 per share.

2. The Class A shareholders to receive one new common share for each eight shares held and options to purchase one share of common stock for $12.50 and one-half of one new share for $15 within five years.

3. The Class B shareholders to receive one new common share for each 12 shares held and options to purchase two-thirds of a share of new common at $12.50 a share and one-third of a new common share at $15 a share within five years.

Besides the elimination of $10,000,000 of unpaid dividends accumulated on the Illinois 7% preferred stock, it was understood that downward revisions of fixed assets would be made.

SUMMARY OF PLAN II

(July 14, 1933)

This plan provided for a merger of the Armour Provision Company (a wholly owned Illinois subsidiary corporation) with Armour and Company, as well as for certain changes in the capital structure of the latter corporation. All outstanding capital stock of the Armour Provision Company was to be surrendered and canceled, and no stock of the surviving corporation was to be issued in exchange therefor. Assets were to be reduced $80,000,000, and the authorized capital stock was to be changed for 10,000,000 shares of new common stock of $10 par value according to the following provisions:

1. Preferred stockholders to receive seven and one-half shares of new common stock for each share held and for the accrued dividends.

2. Class A shareholders to receive one share of new common stock and nine stock purchase warrants for each six shares of Class A stock.

3. Class B shareholders to receive one new common share and 12 stock purchase warrants for each twelve shares of Class B stock.

Present security	Present shares now outstanding	New securities to be outstanding		
		Initial issue		Shares of common stock after exercise of warrants at $12.50 per share
		Shares of common stock	Stock purchase warrants	
Preferred stock	572,313	4,292,347½	. . . . .	4,292,347½
Class A common stock	2,000,000	333,333⅓	3,000,000	3,333,333⅓
Class B common stock	2,000,000	166,666⅔	2,000,000	2,166,666⅔
Total	4,572,313	4,792,347½	5,000,000	9,792,347½

The stock purchase warrants to be issued to the holders of Class A and Class B shares would give the holder of each warrant the right to purchase from the company at any time on or before November 1, 1938, one share of new capital stock at $12.50 per share.

SUMMARY OF PLAN III

(May 29, 1934)

The third plan involved the reduction of stated capital and the reduction of book values of certain properties and assets by about $55,370,000, with a consequent reduction of depreciation and other charges against earnings by approximately $2,150,000 a year.

A 6% cumulative convertible prior preferred stock was to be created, each share convertible at the option of the holder into six shares of new common stock. One share of this new preferred and two shares of the new common were to be exchanged for one share of the old 7% cumulative preferred stock plus accrued dividends.

The present Class A and Class B stock were to be changed into one class of common stock at the rate of one share of new common stock for each share of Class A stock and one-half share of new common stock for each share of Class B stock.

Present security	Present shares now outstanding	New securities to be outstanding, initial issue	
		Shares of 6% cumulative convertible preferred stock	Shares of common stock
7% cumulative preferred stock	572,313	572,313	1,144,626
Class A common stock	2,000,000	....	2,000,000
Class B common stock	2,000,000	....	1,000,000
Total	4,572,313	572,313	4,144,626

In urging the stockholders to ratify the capital readjustment proposed on July 14, 1933 (Plan II), the directors of Armour and Company issued the following statements:

. . . . . .

The main purposes of the readjustment are to bring about simplification of the capital structure and reduction in total capitalization with a corresponding reduction in the amount of capital assets which must, under existing conditions, be maintained through charges to the income account before any dividends can be paid. . . . Specifically, it is contemplated that the company will reduce the values at which its fixed properties and certain of its investments and other assets are carried on its books by approximately $80,000,000.

Such readjustment of book values would make possible a reduction of approximately $2,300,000 in annual depreciation and other charges against earnings, correspondingly improving net results, and enhancing the prospects of the company's being able to distribute portions of its net earnings to stockholders in the form of dividends. It is obvious, however, that this result cannot be accomplished except by a counterbalancing readjustment of the company's capital stock structure.

The plan is not occasioned by any financial exigency on the part of the company. During the past 10 years marked progress has been made in improving its financial condition. During this period, $48,505,600 of funded debt and $16,505,400 of preferred stocks of the company and its subsidiaries have been purchased and retired. At the same time the ratio of current assets to current liabilities has been increased from less than 2 to 1 to over 6.5 to 1. The reduction in funded debt and preferred stocks has been made possible to a considerable extent by the liquidation of nonessential assets and, in more recent years, by the release of funds through the company's investment in inventories being made upon lower price levels.

. . . . . .

Notwithstanding its strong financial condition, however, the dividend record of the company has been far from satisfactory. This has been due partly to the nature of the company's existing capital structure which it is the purpose of the present plan to remedy.

. . . . . .

While . . . the company is not in need of additional working capital, the new money which may be derived from the exercise of the stock purchase warrants or from the sale of reserved stock as may be authorized by the board of directors may be advantageously used in further simplification of the consolidated capital structure of the company and the subsidiaries, in retiring senior securities and thus reducing fixed charges, or for other proper corporate purposes.

. . . . . .

In commenting upon Plan III, the directors of Armour and Company outlined three major reasons for making a change in the capital structure, as follows:

To place the company in a position, under the Illinois law,[1] to pay dividends first on its preferred stock, and thereafter on its common stock, to the extent that such dividends, in the discretion of the board of directors, may be warranted by the company's earnings.

To provide for discharging the accumulated dividends on the preferred stock.

To write down the book values of its properties, investments, and other assets, thereby reducing its depreciation and other charges and placing the company in a position to pay dividends as earnings warrant.

[1] Under the Illinois Business Corporation Act of July 13, 1933, a corporation is not permitted to pay dividends if its net assets are less than its stated capital, or if the payment causes such a condition to be created.

EXHIBIT I
ARMOUR AND COMPANY (ILLINOIS)
CONSOLIDATED BALANCE SHEET

Item	Nov. 2, 1929	Nov. 1, 1930	Oct. 31, 1931	Oct. 29, 1932	Oct. 28, 1933
ASSETS					
Cash	$ 10,742,163	$ 11,902,727	$ 33,208,706	$ 36,485,920	$ 26,010,651
Accounts Receivable	54,840,567	41,150,583	29,318,160	22,427,093	26,969,132
Notes Receivable	10,189,419	10,685,955	8,003,357	6,769,255	6,907,024
Inventories	127,976,680	112,214,954	68,086,007	52,514,177	73,934,800
Total Current Assets	$203,748,829	$175,954,219	$138,616,230	$118,196,445	$133,821,607
Investments	19,877,660	19,691,114	15,420,231*	15,279,213*	16,260,026*
Lands, Buildings, Plants, etc.	199,170,771	198,100,133	194,273,111	190,257,362†	186,306,365†
Refrigerator Cars, Delivery Equipment, Tools, etc.	15,987,052	15,167,345	13,987,603	12,571,163	11,913,675
Franchises and Leaseholds	1,959,748	2,170,052	2,195,329	2,193,966	2,188,485
Deferred Charges	11,569,695	10,307,762	8,846,218	6,616,537	5,689,292
Total	$452,313,755	$421,390,625	$373,338,722	$345,114,686	$356,179,450
LIABILITIES					
Drafts and Acceptances	$ 22,555,969	$ 8,615,743	$ 583,486	$ 182,791	$ 371,155
Accounts Payable	16,504,731	15,883,780	13,140,691	11,244,574	14,007,475
Notes Payable	....	....	....	....	9,663,000
Total Current Liabilities	$ 39,060,700	$ 24,499,523	$ 13,724,177	$ 11,427,365	$ 24,041,630
First Mortgage Bonds:					
Illinois Co. 4½s, 1939	50,000,000	50,000,000	50,000,000	40,355,000	38,076,000
Delaware Co. 5½s, 1943	60,000,000	60,000,000	55,768,000	46,126,400	42,340,100
Morris & Co. 4½s, 1939	13,982,000	13,515,000	12,665,000	9,770,000	9,425,000

EXHIBIT I (*Continued*)
ARMOUR AND COMPANY (ILLINOIS), CONSOLIDATED BALANCE SHEET

Item	Nov. 2, 1929	Nov. 1, 1930	Oct. 31, 1931	Oct. 29, 1932	Oct. 28, 1933
LIABILITIES (*Continued*)					
Gold Notes:					
Morris & Co. 7½% due 1930	$ 9,667,900				
Reserve for Contingencies	1,000,000	$ 2,000,000	$ 2,000,000	$ 2,000,000	
Minority Stockholders' Equity in Subsidiary Companies	1,945,287	1,911,610	1,485,079	1,295,601	$ 1,453,339
Preferred Stocks:					
Delaware Co.	61,620,800	60,972,100	60,323,400	59,674,700	59,026,000
N. A. Provision Co.	8,600,000	6,115,900			
Illinois Co.	59,298,400	59,298,400	57,231,300	57,231,300	57,231,300
Class B Common Stock	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000
Class A Common Stock	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000
Surplus	47,138,668	43,078,092	20,141,766	17,234,320	24,586,081
Total	$452,313,755	$421,390,625	$373,338,722	$345,114,686	$356,179,450
Net Working Capital	$164,688,129	$151,454,696	$124,892,053	$106,769,080	$109,779,977

* Including companies' securities at cost of $1,454,352 in 1931; $1,501,015 in 1932; $2,839,700 in 1933.
† Less reserve for depreciation: 1933, $93,584,958; 1932, $90,743,169.
Sources: Company reports; Poor's *Industrials*.

EXHIBIT 2
ARMOUR AND COMPANY (ILLINOIS)
CONSOLIDATED INCOME ACCOUNT

Item	Year ended Nov. 2, 1929	Year ended Nov. 1, 1930	Year ended Oct. 31, 1931	Year ended Oct. 29, 1932	Year ended Oct. 28, 1933
Net sales (estimated)	$900,000,000	$900,000,000	$668,000,000	$468,000,000	
Net operating revenue	29,383,209	21,388,104	2,682,619†	9,255,103§	$20,376,363
Deductions:					
Depreciation	$ 8,639,617	$ 7,314,958	$ 7,172,289	$ 7,039,462	$ 6,883,671
Interest charges	10,933,074	9,332,119	7,484,228	6,073,206	5,371,051
Total deductions	$ 19,572,691	$ 16,647,077	$ 14,656,517	$ 13,112,668	$12,254,722
Net income	9,810,518	4,741,027	17,339,136†	3,857,565†	8,121,641
Preferred dividends:					
Delaware Company	4,324,808	4,279,399			
N. A. Provision Company	516,000	516,000	5,519,928	4,188,581	3,857,637
Illinois Company	4,150,888	4,150,888			
Total dividends	$ 8,991,696	$ 8,946,287	$ 5,519,928	$ 4,188,581	$ 3,857,637
Deficit after dividends	818,822*	4,205,260	22,859,064	8,046,146	4,264,004*
Profit from purchase and retirement of company's bonds	...	...	935,001	5,520,104	728,020
Balance, deficit	$ 818,822*	$ 4,205,260	$ 21,924,063	$ 2,526,042	$ 4,992,024*
Surplus adjustments	...	144,684			
Surplus at beginning of year	46,788,115	47,138,668	43,078,092	20,141,766	17,234,320
Balance, surplus	$ 47,606,937	$ 43,078,092	$ 21,154,029	$ 17,615,724	$22,226,344
Special charges not applicable to year's operations	468,269	...	1,012,263‡	381,404‡	2,359,737‖
Surplus	$ 47,138,668	$ 43,078,092	$ 20,141,766	$ 17,234,320	$24,586,081

* Surplus.
† Loss.
‡ After deducting credits arising on purchase and retirement of companies' preferred stock.
§ Includes $203,092 dividends on 7 % preferred stock of Armour and Company of Delaware, held in its treasury.
‖ Credits not applicable to the year's operations, including adjustments of reserves and credits arising from purchase and retirement of companies' preferred stock.
Sources: Company reports; Poor's *Industrials*.

EXHIBIT 3
ARMOUR AND COMPANY (ILLINOIS)
PRICE RANGE OF PREFERRED AND COMMON STOCK

Date	Preferred		Common, Class A		Common, Class B	
	High	Low	High	Low	High	Low
1929	86	57	18⅛	5⅛	10¼	2¾
1930	65	25¼	8⅛	2¾	4⅜	1½
1931	47	5⅛	4½	¾	2⅞	½
1932	15⅞	3½	2¾	⅝	2	⅜
1933:						
May	36	20	6⅝	3¼	4	1⅞
June	70⅜	35	7¾	4⅜	4½	2⅝
July	93	60	7¾	4	5	2¾
August	72	55	6⅜	4⅝	4	2⅞
September	62	48½	5½	4	3¾	2¾
October	53¼	31¼	4⅛	2⅝	2⅛	1⅝
November	46¾	36¾	4	2¾	2⅝	2⅛
December	64	39	4⅞	3⅛	2⅞	2
1934:						
January	63⅝	55	6¼	4¼	3⅛	2¼
February	64¼	56¾	6⅞	5⅛	3⅜	2⅝
March	61½	57¼	6¼	5½	3	2⅝
April	75⅝	62¼	8	6¼	3⅞	3
May	71⅜	59	6⅞	5½	3¼	2½

Source: *Bank and Quotation Record.*

2. CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY

PROPOSED REORGANIZATION UNDER SECTION 77 OF THE BANKRUPTCY ACT[1]

In accordance with Section 77 of the Bankruptcy Act as amended in March, 1933, a bondholders' protective committee filed with the Interstate Commerce Commission on June 27, 1934, a plan of reorganization for the Chicago and Eastern Illinois Railway Company. The committee represented the owners of the company's 5% general mortgage bonds which were held largely by insurance companies and savings banks. Since October, 1933, the company had operated under the supervision of a trustee in bankruptcy whose appointment was brought about by petition of the Reconstruction Finance Corporation, one of the principal creditors of the railroad.

The Chicago and Eastern Illinois Railway Company was incorporated December 13, 1920, to acquire, in accordance with a reorganization plan, the property and franchises of the Chicago

[1] Section 77, an amendment to the Bankruptcy Act of 1898, deals with the reorganization of railroads engaged in interstate commerce.

a. It provides that any railroad corporation or, subject to the approval of the Interstate Commerce Commission, creditors with claims aggregating not less than 5% of all indebtedness may file in the Federal district court a petition that the railroad is insolvent or unable to meet its debts as they mature and that a reorganization is to be effected.

b. The plan of reorganization (1) shall include a proposal to modify or alter the rights of creditors generally either through the issuance of new securities or otherwise; (2) may modify the rights of stockholders; (3) shall provide adequate means for the execution of the plan; (4) may deal with all or any part of the property of the debtor.

c. A trustee or trustees shall be appointed.

d. Before creditors or stockholders of the debtor are asked finally to accept any plan of reorganization, the Interstate Commerce Commission shall hold a public hearing at which the debtor shall present its plan of reorganization and at which such a plan may be presented by the trustee or by or on behalf of creditors of the debtor, being not less than 10 percentum in amount of any class of creditors. Following such hearing the commission shall recommend a plan of reorganization that, in its opinion, will be equitable to all classes of creditors and stockholders and will be financially advisable.

e. A plan of reorganization shall not be finally approved by the commission, with certain exceptions, until it has been accepted by creditors representing two-thirds of the claims and by two-thirds of the stockholders of each class.

f. No plan of reorganization shall be confirmed without the approval of the Interstate Commerce Commission.

g. Upon approval by the Interstate Commerce Commission, the judge shall confirm the plan if satisfied that it is just and equitable in certain specified respects.—*Bankruptcy Laws of the United States*, Washington, Government Printing Office, 1934.

For a discussion of Sec. 77, see also H. B. Wilson, "Railroad Reorganization under Section 77 of the Bankruptcy Act," *American Bar Association Journal*, Vol. 19, pp. 665–668, November, 1933.

and Eastern Illinois Railroad Company. The latter company came into existence in 1894 as the result of a consolidation of

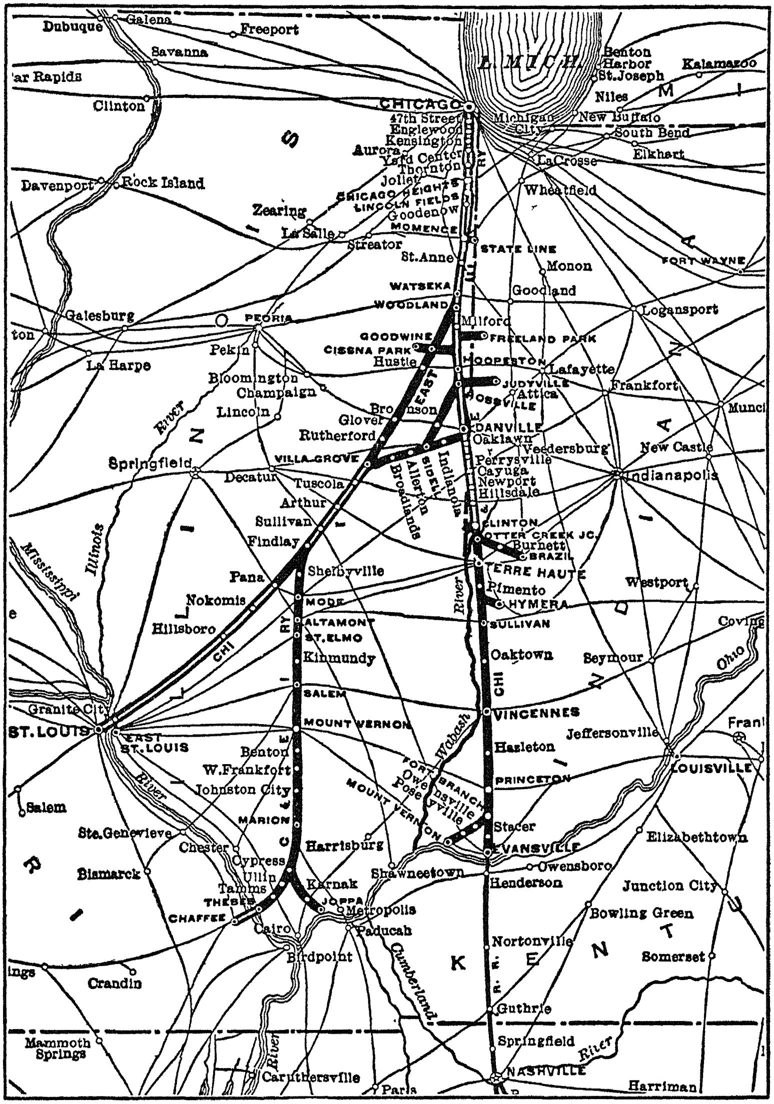

EXHIBIT 1.—Lines of the Chicago and Eastern Illinois Railway Company.

railroad properties and had been in receivership from 1913 to 1920. At the time of the proposed reorganization in 1934, control

of the company was held by the Chesapeake and Ohio Railway Company, a Van Sweringen property. Through a subsidiary, the Virginia Transportation Company, the Chesapeake and Ohio Railway Company owned 42% of the capital stock, consisting of 64,904 shares of the preferred and 131,268 shares of the common stock of the Chicago and Eastern Illinois Railway Company.

The plan filed with the Interstate Commerce Commission by the reorganization committee contained the following proposals:

1. The managers of the reorganization should be not more than three and should include C. M. Shanks, chairman of the general mortgage bondholders' protective committee, and a joint nominee of the Reconstruction Finance Corporation and the Railroad Credit Corporation.[1] The managers should have discretionary power:

a. To make arrangements financial or otherwise for organizing a new company to take over assets and property of the old company.

b. To provide cash "necessary to take up for extension consolidated bonds of the old company not offered for extension, or for any other purpose, by the sale or pledge of prior and refunding bonds or otherwise."

2. A voting trust of 10 years' duration should be established for the preferred stock of the new company. The trust should be terminable at any time upon a vote representing 80% of the shares so trusteed.

3. The funded debt should be reduced from $42,395,428 to $27,040,900 and fixed charges from $2,153,881 to $196,464, not including rentals of $155,000 for leased property.

Existing securities were to be treated in the following manner:

1. Trustee's certificates held by the P.W.A. ($240,000) were to be assumed with their present lien by a new corporation to be formed to take over the assets and business of the old company.

2. Evansville Belt first mortgage 5% bonds ($142,000) were to be assumed with their present lien.

3. Equipment trust obligations, 5s and 6s ($849,400), were to be assumed with their present lien.

4. Consolidated mortgage 6% bonds ($2,736,000) were to be assumed and extended for a period of 20 years from October 1, 1934, with their present lien, subject, to the extent they were now subject, to the

[1] Participated in by all Class I railroads, the Railroad Credit Corporation was organized in 1931, with the approval of the Interstate Commerce Commission, to distribute, as loans, funds derived from the pooling of special rate increases. In this way the Interstate Commerce Commission planned to aid all freight-carrying roads facing a deficiency in earnings below interest charges but not already in default. The period in which loans could be made by the Railroad Credit Corporation terminated May 31, 1933, and its activities after that date were limited to liquidation.

trustee's certificates now outstanding, but at a coupon rate of 5%. The extended consolidated bonds were to have the benefit of a contingent annual sinking fund payment of $27,360, noncumulative. The extended bonds were to be callable at 105 on any interest date for purposes of the sinking fund and after three years were to be callable, in whole or in part for any purpose, at 105.

5. The indebtedness to the Reconstruction Finance Corporation and the Railroad Credit Corporation aggregating $7,718,992 with accrued and unpaid interest, if any, was to be refunded dollar for dollar by prior and refunding mortgage bonds of an issue of $17,000,000 at the maximum to be outstanding at any one time, which bonds, in addition to such refunding should also, to the extent of $9,281,008, be available for refunding the consolidated bonds and for emergency financing. The prior and refunding mortgage would constitute a first lien upon the entire system (approximately 821 miles owned), subject, however, to the liens of the trustee's certificates, the Evansville Belt mortgage and the consolidated mortgage, which latter was a prior lien on approximately 107 miles of main line and 23 miles of branch line. The prior and refunding bonds issued to the Reconstruction Finance Corporation and the Railroad Credit Corporation were to be denominated Series A bonds, were to mature in 1965, and were to bear interest at the rate of 5% cumulative, but payable only if earned after all fixed interest charges and sinking fund payment of $27,360. The Series A bonds were callable in whole or in part on any interest date at par.

6. *a.* The general mortgage bonds ($30,709,036) were, to the extent of one-half of their amount, *i.e.*, $15,354,518, to be refunded into a new adjustment mortgage of $15,354,518, due 1970, covering all the properties embraced in, but subject to, the prior and refunding mortgage. The interest rate on the adjustment mortgage bonds was to be 5%, noncumulative, payable only if earned after fixed interest charges, sinking fund payment of $27,360, and interest charges on the prior and refunding bonds. The adjustment mortgage bonds were to be callable in whole or in part on any interest date at 102.

b. Holders of general mortgage bonds were to receive the other half of their debt, *i.e.*, $15,354,518, at par in the form of new preferred stock of the par value of $100 a share; such stock to be not more than 6% noncumulative and preferred as to dividends before common stock and up to par as to assets on dissolution; to have three votes per share at all times and the sole right to vote for directors except at any election when the preferred stock had received its full dividend in or for the preceding year. The preferred stock was redeemable in whole or in part at 101.

c. Holders of general mortgage bonds were to receive, in addition, against their arrearages of interest, common stock of the new company.

7. It was assumed that the six months' claims and the greater portion of all unsecured claims against the old company would have been settled out of the current cash. Six months' claims would be

paid in cash. To the extent, if at all, that any liabilities for unsecured claims still remained at the time of reorganization, claimants would receive common stock.

8. *a.* Common stock without par value was to be issued by the new company, the number of such shares to be one for each $100 of book value of capitalizable assets over and above the foregoing items of credit. Such stock was to have one vote per share and was to be subject to the rights of the preferred stock.

b. Stock was to be distributed (1) to general mortgage bondholders against their arrears of interest to the date of reorganization on the basis of 10 shares for each $100 of such arrears (such arrears on the bonds in the hands of the public on May 1, 1934, amounted to $2,303,-177); (2) to the holders of unsecured claims on the basis of 2 shares for each $100 of such claims; (3) to the holders of preferred stock of the old company on the basis of 1 share for each 3 shares now held by them, *i.e.*, 73,487 shares of new common for 220,461 shares of old preferred; and (4) to holders of common stock of the old company on the basis of 1 share for each 10 shares now held by them, *i.e.*, 23,845 shares of new common for 238,453 of old common. (5) If the capitalizable assets (*a*) should be insufficient to permit of the foregoing distribution of common stock, the respective amounts of stock to be received by them would be proportionately reduced; (*b*) should be of such amount to leave a surplus of common stock undistributed, such surplus was to be allocated to each of the groups (1), (2), (3), and (4) in proportion to the foregoing provisions.

In commenting on the proposed plan, the reorganization committee stated that future earnings of the road could only be a matter of conjecture. With the exception of a slight increase in 1933, the steady decline in passenger revenues from a peak of $5,029,000 in 1923 to $1,180,000 in 1932 made it appear improbable that passenger revenues could ever be recovered. In addition to truck competition, the enlarged use of oil and natural gas and the increased thermal efficiency of coal-consuming power plants had an adverse effect upon the earnings of this railroad, which was dependent to a large extent upon coal traffic. The committee pointed out further that

> . . . the general uncertainties of the transportation industry, including mounting taxation legislation and regulation as to rates, wages, working conditions, and pension and unemployment funds, the competition of subsidized waterways, and noncompensatory expenditures for elimination of highway crossings, all render highly speculative any estimates of future earnings which exceed to any great extent present levels.

The committee presented two estimates of earnings (see Exhibit 2) which should result from a "reasonable" increase in

traffic at some future time. Estimate A assumed that, of the loss of traffic from the five-year average 1928–1932 to the levels of 1933, one-half would be recovered. Estimate B assumed revenues 10% higher than Estimate A.

EXHIBIT 2
CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY
ESTIMATES OF REVENUES AND EXPENSES COMPARED WITH ACTUAL FIGURES FOR 1931

Item	Estimates		Actual
	A	B	Year 1931
Gross revenues	$15,000,000	$16,500,000	$15,136,000
Working expenses	14,200,000	15,000,000	16,837,000
Net railway operating income	$ 800,000	$ 1,500,000	$ 1,701,000[d]
Nonoperating income	150,000	150,000	311,000
Gross income	$ 950,000	$ 1,650,000	$ 1,390,000[d]

[d] Deficit.

In criticism of the reorganization plan proposed, Kenneth D. Steere, chairman of the board of directors of the Chicago and Eastern Illinois Railway Company, said in part as follows: "Any plan which appraises the property on the basis of the present volume of business, as does the plan proposed by Mr. Shanks' committees, requires a needless sacrifice on the part of bondholders and stockholders."

Balance sheets and income accounts for the company, 1929–1933, are shown in Exhibits 3 and 4. Exhibit 5 gives prices of securities of the company for selected dates during the first half of 1934.

1. What should be the objectives of a plan for reorganization of the Chicago and Eastern Illinois Railway Company?

2. To what extent does the proposed plan accomplish these objectives?

EXHIBIT 3

CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY

GENERAL BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932	1933
ASSETS					
Investment in road	$ 56,291,316	$56,609,609	$56,726,926	$56,816,197	$77,513,252
Investment in equipment	28,528,268	20,812,440	20,649,966	20,641,365	
Improvement on leased railway property	152,723	155,091	155,327	164,516	167,327
Sinking funds	19	11	....	7	7
Deposits in lieu of mortgaged property sold	624	486	1,405	102,452	211,915
Miscellaneous physical property	1,760,154	1,770,835	1,773,292	1,787,193	1,784,090
Investments in affiliated companies	5,801,351	4,670,015	4,663,575	4,967,325	4,990,187
Other investments	987,445	986,541	151	7,881	61,005
Deferred assets	61,331	58,518	60,099	45,170	48,174
Other unadjusted debits	879,772	955,736	559,845	529,151	254,880
CURRENT ASSETS					
Cash	818,105	983,956	354,923	836,307	412,227
U. S. Liberty Loan bonds	2,668,009*	1,613,043†			
Demand loans and deposits	800,000				
Special deposits	42,745	40,048	40,170	40,520	24,675
Loans and bills receivable	12,684	4,401	4,875	4,843	6,234
Service balances	420,559	283,795	152,882	191,652	176,544
Agents and conductors	301,777	63,548	155,410	190,012	214,296
Miscellaneous accounts receivable	712,051	542,970	576,643	515,702	1,140,033
Materials and supplies	1,232,011	1,222,376	993,838	727,457	583,528
Interest, dividends, and rents receivable	67,846	147,724	30,391	25,226	28,982
Other current assets	21,762	8,289	2,150	4,368	1,810
Total current assets	$ 7,097,549	$ 4,910,150	$ 2,311,282	$ 2,536,087	$ 2,588,329
Total assets	$101,560,552	$90,929,432	$86,901,868	$87,597,344	$87,619,166

EXHIBIT 3 (*Continued*)
CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY
GENERAL BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932	1933
LIABILITIES					
Preferred stock	$ 22,046,100	$22,046,100	$22,046,100	$22,046,100	$22,046,100
Common stock	23,845,300	23,845,300	23,845,300	23,845,300	23,845,300
Funded debt	41,111,436	37,115,436	36,413,336	34,985,236	34,837,836
Deferred liabilities	109,618	129,654	107,392	85,898	73,535
Accrued depreciation—equipment	4,120,806	3,118,318	3,495,031	3,896,487	4,297,987
Other unadjusted credits	380,951	292,520	247,388	279,841	234,952
Total appropriated surplus	2,526,464	2,970,689	3,653,245	5,139,133	5,319,304
Profit and loss surplus	1,489,142	6,723,115[d]	10,658,552[d]	14,462,380[d]	16,943,949[d]
CURRENT LIABILITIES					
R. F. C. loans	....	....	....	5,840,000	7,758,055
R. R. C. Corp. loans	....	....	....	2,040,590	
Loans and bills payable	810,900	3,520,000	3,200,000		
Traffic and car service balance payable	558,136	467,573	369,574	320,978	297,999
Audited accounts and wages payable	1,709,313	1,327,465	1,498,171	982,701	1,750,183
Miscellaneous accounts payable	144,256	117,322	117,636	102,949	86,740
Interest matured unpaid	42,745	40,720	40,170	40,520	1,792,605
Unmatured interest and rents accrued	839,201	827,960	860,773	887,368	865,734
Tax liability	1,764,661	1,773,508	1,631,094	1,541,587	1,323,941
Other current liabilities	61,523	59,982	35,210	25,036	32,844
Total current liabilities	$ 5,930,735	$ 8,134,530	$ 7,752,628	$11,781,729	$13,908,101
Total liabilities	$101,560,552	$90,929,432	$86,901,868	$87,597,344	$87,619,166
Net working capital	$ 1,166,814	$ 3,224,380‡	$ 5,441,346‡	$ 9,245,642‡	$11,319,772‡

* Includes $1,050,000 Illinois Merchants Trust Company participating certificates.
† U. S. Treasury bonds.
‡ Excess of current liabilities over current assets.
[d] Deficit.
Source: *Standard Corporation Records.*

EXHIBIT 4
CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY
INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932	1933
Average miles operated	946.24	946.24	938.95	938.89	
OPERATING REVENUES					
Freight	$19,534,920	$15,387,823	$11,856,112	$ 9,819,162	
Passenger	3,410,201	2,618,533	1,838,814	1,179,967	
Other transportation revenue	2,159,675*	1,527,239	1,276,857	1,083,211	
Nontransportation revenue	293,479	250,703	164,178	107,633	
Total operating revenue	$25,398,275	$19,784,298	$15,135,961	$12,189,973	$12,218,449
OPERATING EXPENSES					
Maintenance of way and structure	$ 3,011,916	$ 2,210,562	$ 1,906,484	$ 1,587,232	$ 1,489,744
Maintenance of equipment	5,356,770	9,280,045†	3,201,491	2,151,415	1,749,788
Traffic expenses	941,943	943,137	825,059	696,058	581,817
Transportation expenses	9,360,420	8,306,537	6,856,958	5,435,627	5,047,139
General miscellaneous expenses	1,060,068	1,020,351	926,595	791,704	748,385
Transportation for invoices (cr.)	38,020	59,137	11,935	15,644	15,815
Total operating expenses	$19,693,097	$21,701,495	$13,704,652	$10,646,392	$ 9,601,058
Per cent of expenses to gross	(77 53)	(109 69)	(90 54)	(87.34)	
Net operating revenue	$ 5,705,178	$ 1,917,197[d]	$ 1,431,309	$ 1,543,581	$ 2,617,391
Tax accruals	1,670,000	1,683,000	1,390,000	1,280,000	920,000
Uncollected railway revenue	8,871	5,889	5,451	6,787	3,792
Railway operating income	$ 4,026,307	$ 3,606,086[d]	$ 35,858	$ 256,794	$ 1,693,599
Hire of equipment—net debit	1,186,815	1,218,006	992,146	796,092	799,384
Joint facility rents—net debit	630,459	681,877	744,213	744,039	686,918
Net railway operating income	$ 2,209,033	$ 5,505,969[d]	$ 1,700,501[d]	$ 1,283,337[d]	$ 207,297
Other income	617,058	582,741	311,806	197,771	134,150
Gross income	$ 2,826,091	$ 4,923,228[d]	$ 1,388,695[d]	$ 1,085,566[d]	$ 341,447

EXHIBIT 4 (*Continued*)
CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY
INCOME ACCOUNT, YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932	1933
Deductions:					
Miscellaneous tax accruals	$ 22,681	$ 22,607	$ 27,600	$ 21,383	$ 16,900
Miscellaneous charges	32,081	29,926	18,638	19,690	3,780
Fixed charges:					
Interest on funded debt	2,126,354	1,933,452	1,872,045	1,819,325	1,772,353
Interest on unfunded debt	9,799	186,893	178,488	307,553	413,649
Rentals	156,208	155,575	155,653	157,902	155,269
Total fixed charges	$ 2,292,361	$ 2,275,920	$ 2,206,186	$ 2,284,780	$ 2,341,271
Total deductions	2,347,123	2,328,453	2,252,424	2,325,853	2,361,951
Net income	478,968	7,251,681[d]	3,641,119[d]	3,411,419[d]	2,020,504[d]
Applied to sinking and other reserve funds	278,144	297,583	316,421	356,227	395,425
Surplus for year	$ 200,824	$ 7,549,264[d]	$ 3,957,540[d]	$ 3,767,646[d]	$ 2,415,929[d]
Balance at beginning of year	1,332,602	1,489,142	6,723,116[d]	10,658,552[d]	14,462,380[d]
Sundry credits and credit adjustment	93,378	147,272	442,939	1,132,172	5,136
Sundry debits and debit adjustment	137,662	810,266	420,835	1,168,354	70,776
Surplus as per balance sheet, Dec. 31	$ 1,489,142	$ 6,723,116[d]	$10,658,552[d]	$14,462,380[d]	$16,943,949[d]
Earned per share:					
On preferred stock outstanding Dec. 31	$2.17	$32.89[d]	$16.52[d]	$15.47[d]	$ 9.16[d]
On common stock outstanding Dec. 31	3.54[d]	35.96[d]	20.82[d]	19.85[d]	14.02[d]

* Includes $311,634 back mail pay.
† Includes $4,700,000 special retirement of equipment.
[d] Deficit.
Source: *Standard Corporation Records.*

EXHIBIT 5
CHICAGO AND EASTERN ILLINOIS RAILWAY COMPANY
SECURITY PRICES

1934	1st Consolidated General 6s 1934		General 5s 1951 (new company)		6 % preferred		Common stock	
	High	Low	High	Low	High	Low	High	Low
January	60	53	15½	10	4	1⅞	3½	2⅝
February	81⅛	75⅛	25½	15	8	3¾	7	3½
March	76	74	22¾	18	6¼	4⅞	5	4½
April	80	75	20	17¼	6	5	5	4½
May	81	76	18	14	4¾	3½	4	3½
Week ending:								
June 9	....	....	16⅛*	14	4	3⅝	3⅞	3¼
16	....	....	15⅝*	15	4	3⅞	4	3
23	....	....	15¼*	13½	3¾	3½	4	3
30	.	....	15½*	14	4⅛	3¼	3⅜	3

* Selling flat due to default in principal, interest, or both.
Sources: *Bank and Quotation Record; The Annalist.*

3. SNIDER PACKING CORPORATION

PROPOSED REORGANIZATION OF FINANCIAL STRUCTURE

Towards the close of 1931 the board of directors of the Snider Packing Corporation and a protective committee representing holders of the company's five-year 6% convertible gold notes recommended that the financial structure of the corporation be reorganized. Such action was deemed necessary because of the weak financial position of the company and the probability that it would not be able to retire $2,598,000 of its 6% convertible gold notes which would mature on May 1, 1932.

The company was incorporated in New York in 1919, and acquired the plants, businesses, trade-marks, goodwill, etc., of a number of other companies which for many years had specialized in packing and selling vegetables, fruits, jams, ketchup, and other food products. It owned and operated 27 plants located in New York, New Jersey, Delaware, Maryland, Illinois, and Indiana and maintained 65 receiving stations. It also owned all the common stock of the Mohawk and Genesee Farms Corporation, which owned 1,150 acres of farm lands in the Mohawk and Genesee Valleys of New York, and of the T. A. Snider Preserve Company; and a controlling interest in New York Pea Packers, Inc., all of whose canning plants it operated under a rental contract.

The 6% convertible notes were issued by the company in 1927

> . . . in the principal amount of $3,000,000 to provide additional working capital required because of radical changes in merchandising methods which were taking place in the canning industry. These changes . . . required the canning companies . . . to carry the finished inventory accumulated during the three months' packing season until it could be gradually distributed throughout the year in accordance with consumption demands, where previously it had been the practice to sell the output before and during the packing season, for delivery immediately after completion of the pack.

During 1930 and 1931 this requirement and adverse conditions in the canning industry "resulted in an abnormal and competitive effort to raise cash, particularly among the smaller canners. The resultant low prices . . . affected all companies" and necessitated drastic mark-downs of inventories.

In the years immediately following its incorporation, with the exception of 1921, the Snider Packing Corporation operated at a substantial average profit. After 1925, however, results of operation were less successful, as is indicated by Exhibit 1.

The conditions which resulted in the comparatively large loss from operations for the year ended January 31, 1932, as well as the position of the company and its prospects for the future, were discussed in a letter of March 24, 1932, from the president to the stockholders, in part, as follows:

Operations for the year resulted in a loss of $311,446.43 before interest and depreciation, and without including the amount necessary to adjust January 31, 1931, inventory to the lower level of costs of the 1931 season's pack. . . .

Sales as compared with the preceding fiscal year increased in unit volume approximately 3%, while aggregate dollar volume of sales decreased approximately 19%. Distribution of Snider brand goods increased.

Current liabilities decreased $174,036.81 as compared with the preceding year, while current assets decreased $1,422,527.47. The result of operations for the year was, therefore, a decrease of $1,248,490.66 in net working capital. The major portion of this shrinkage in net working capital was caused by the decrease in prices of canned foods during the year. As at January 31, 1931, the inventory of finished stock of canned goods was valued at $4,797,671.34 and consisted of 2,243,683 cases of goods. As at January 31, 1932, inventory of finished stock of canned goods amounted to 2,202,809 cases, or practically the same number of cases as at the close of the preceding fiscal year, but was valued at $3,973,140.63, a decrease of $824,530.71 or over 17%.

Although every effort was made in the 1931 pack season to reduce manufacturing costs to the minimum, it now seems probable in view of the continued fairly steady decline in commodity prices generally and the weakness during the past three or four months in prices of canned goods that your corporation may be forced to take a further loss on the inventory carried over from the fiscal year ended January 31, 1932, into the current fiscal year. To provide for this contingency your board of directors has deemed it advisable to set up a reserve against possible inventory loss in the amount of $500,000.

Corporations in the canning industry are in the position of having to manufacture the major portion of their products during a short summer season. Consequently manufacturing costs are largely governed by the level of prices of raw materials, labor and supplies during that season. Declines during the remainder of the year in the general level of prices tend to weaken the price which such corporations receive for their product, although there is no means for further reducing manufacturing costs until the next packing season. Consequently, in periods of generally declining prices, the industry faces substantial

inventory losses. As against this, in periods of strengthening prices, the reverse is true and a corresponding benefit should accrue to the industry.

Your corporation's plants and equipment are in good condition and capable of producing as fine a quality of goods as at any time in the past. Its products have been maintained in quality, and those on hand at the close of the year appear to be conservatively valued, after deducting the reserve set up against possible inventory loss, and giving consideration to the current low prices for canned foods. If your corporation's present position is not further embarrassed, it is the opinion of your officers and directors that it can continue to function, and if the long decline in prices for its product should terminate with the current fiscal year, it will be able not only to carry on but to produce a satisfactory profit. Although working capital has decreased substantially, the corporation's present net working capital appears sufficient for its needs, owing largely to the increasing efficiency of each dollar of working capital; *i.e.*, the lower price level for raw materials, labor, and supplies compensates to a large extent for the net decrease in working capital.

Conditions prevailing in the canning industry in February, 1932, were unsatisfactory, with prices so low as to eliminate profits for the great majority of packers. Little improvement was in prospect unless the prevalent disposition to limit the 1932 crop production to an absolute minimum could be carried out, a development which would place the industry in a moderately more favorable position later in the year.

The capital structure of the Snider Packing Corporation as of January 31, 1932, included only three classes of securities:

1. \$2,598,000 of 6% convertible gold notes due May 1, 1932. These were a direct obligation of the company but were not secured by any mortgage. Interest on these notes was paid regularly on May 1 and November 1, 1931; consequently no arrears of interest were outstanding at the end of January, 1932.
2. 60,000 shares of \$6 cumulative, convertible, no-par preferred stock. In the event of liquidation, this stock was entitled to \$100 a share and accrued dividends before any distribution to common stock. Dividends on this stock, each share of which had one vote, were paid to December 1, 1926.
3. 288,311 shares of no-par common stock, of which 138,311 shares were outstanding and 150,000 shares were reserved for conversion of the gold notes and the preferred stock. No dividends had been paid on this stock since September, 1926. Each share of the common stock had one vote.

Prices of these securities in recent years had ranged as follows:

Year	6% notes	Preferred stock	Common stock
1927	99 to 112	44 to 52¼	11⅝ to 16¾
1928	93¼ to 131½	31 to 60	11 to 20
1929	57½ to 107⅛	14 to 64½	3⅛ to 16¼
1930	39¼ to 75	8 to 36¾	1½ to 7½
1931	19½ to 54½	2 to 15⅝	¾ to 4¾
1932	24 to 38*	1½ to 4¼†	⅜ to 1†

* January 1 to 30.
† January to February.

Operating statements and balance sheets of the company are shown in Exhibits 1 and 2.

1. What specific objectives should be considered in a reorganization of the Snider Packing Corporation?

2. Present and defend a practicable plan for reorganization of the company.

EXHIBIT 1
SNIDER PACKING CORPORATION
INCLUDING WHOLLY OWNED SUBSIDIARIES
CONSOLIDATED INCOME ACCOUNT, YEARS ENDED JANUARY 31

Item	Dec. 31, 1925	1927*	1928	1929	1930	1931	1932
Net sales	$10,270,706	$11,044,145	$8,455,078	$9,225,163	$11,050,405	$8,838,377	$7,193,587
Gross profit	3,649,869	2,026,005	2,254,579	2,314,879	2,830,633	2,499,423	1,619,218
Expense	2,257,073	2,572,389	2,332,848	2,092,960	2,133,737	2,064,783	1,807,202
Depreciation, etc	387,752	433,013	410,890	417,642	406,784	337,035	378,413
Net income	$ 1,005,044	$ 979,397[d]	$ 489,159[d]	$ 195,723[d]	$ 290,112	$ 97,605	$ 566,397[d]
Other income	42,919	58,413[d]	48,031[d]	65,686[d]	8,031	29,594	123,462[d]
Total income	$ 1,047,963	$ 1,037,810[d]	$ 537,190[d]	$ 261,409[d]	$ 298,143	$ 127,199	$ 689,859[d]
Fixed charges	200,153	200,535	240,452	228,811	228,062	246,945	283,039
Federal taxes	88,830						
Inventory adjustment	....	....	....	....	....	....	700,857
Balance	$ 758,980	$ 1,238,345[d]	$ 777,642[d]	$ 490,220[d]	$ 70,081	$ 119,746[d]	$1,673,755[d]

* For 13 months ended January 31, 1927.
[d] Deficit.
Compiled from company reports; Moody's *Industrials*.

EXHIBIT 2
SNIDER PACKING CORPORATION
CONSOLIDATED BALANCE SHEET, AS OF JANUARY 31

Item	1927*	1928	1929	1930	1931	1932
ASSETS						
Property Account	$ 8,155,422	$ 7,637,564	$7,745,634	$7,855,523	$ 8,115,949	$7,991,204
Depreciation Reserve	3,332,614	3,505,024	3,903,285	4,160,547	4,436,745	4,752,802
Net Value	$ 4,822,808	$ 4,132,540	$3,842,349	$3,694,976	$ 3,679,204	$3,238,402
Investments	98,635	171,703	167,414	163,125	157,581	154,711
Accounts and Notes Receivable	1,719,850	866,043				
Accounts and Trade Acceptances Receivable	....	....	708,578	1,156,888	1,111,233	547,555
Cash	143,370	397,957	258,356	546,679	462,973	572,748
Inventory	4,991,899	3,765,819	3,417,309	3,224,420	5,317,200	4,348,576
Other Assets	....	20,500				
Deferred Charges	36,104	365,540	28,261	40,806	33,798	75,173
Deficit	....	295,175				
Total	$11,812,666	$10,015,277	$8,422,267	$8,826,894	$10,761,989	$8,937,165
LIABILITIES						
Preferred Stock	$ 5,100,000	$ 5,100,000	$5,100,000	$5,100,000	$ 5,100,000	$5,100,000
Common Stock	648,808	649,808	651,141	656,142	672,806	691,556
Minority Interest	311,000					
Funded Debt	....	2,997,000	2,993,000	2,625,000	2,598,000	2,598,000
Notes Payable	2,923,984	540,000	....	400,000	2,500,000	647,433
Bankers Acceptances Payable†	....	....	....	....	....	1,600,000
Accounts Payable	730,606	200,649				
Accrued Accounts	....	70,445				
Accounts Payable and Accruals	....	....	281,862	434,637	374,483	453,013
Reserve for Contingencies	....	....	149,801	172,925	187,403	187,871
Reserve for Possible Inventory Loss		....	....	....	....	500,000
Other Reserves	83,379	457,375				
Surplus	2,014,889					
Deficit	....	....	753,537	561,810	670,703	2,840,708
Total	$11,812,666	$10,015,277	$8,422,267	$8,826,894	$10,761,989	$8,937,165

* Including New York Pea Packers, Inc., and giving effect to new financing.
† Obligation of subsidiary, guaranteed by parent company, secured by pledged inventory.
Compiled from company reports; Moody's *Industrials*.

4. CANEBOARD COMPANY

PLAN FOR TERMINATING RECEIVERSHIP

Under the leadership of the banking firm of Dalton & Company, a reorganization committee composed of important creditors and security holders of the Caneboard Company was formed in the spring of 1934. The committee was of the opinion that the condition and prospects of the company warranted a termination of the receivership, provided a satisfactory plan could be put into effect. The objectives of this plan would be to reduce funded debt, to eliminate arrearages of interest and dividends, and to increase working capital.

The Caneboard Company was incorporated in Delaware in 1920 to manufacture and distribute caneboard, a building material made from sugar-cane pulp. Not only did this product possess structural strength comparable with that of lumber, but it was waterproof, was an excellent insulator, absorbed sound, and could be treated directly with plaster and stucco. The building industry provided the largest market for caneboard although it was also used in the manufacture of refrigerators and refrigerator cars.

The business expanded rapidly from the company's inception, its net sales increasing from $484,523 in 1922 to $10,317,640 in 1929. For financing the increasing volume of sales and other corporate requirements, the company sold common and preferred stock and reinvested a portion of its earnings. After all charges including depreciation and interest, earnings had averaged, in the years 1926 through 1929, over $1,000,000 annually. To secure additional funds, the company issued, in 1924, $1,250,000 of first mortgage 6½% sinking fund convertible gold bonds, Series A, due in 1939, and two years later sold $2,000,000 of 10-year 6% convertible sinking fund gold debentures.

From the outset the company had been managed by men long experienced in paper making and other allied industries. The president, Mr. C. E. Moulton, had served for 10 years as vice president of the Concord Paper Company. During his connection with the Caneboard Company he was also an officer of several sugar companies.

For the Caneboard Company the problem of securing an adequate and fairly priced supply of raw material was of major importance. As a result of the seasonal nature of the sugar

industry, the company had to purchase its fiber requirements for the year in November, December, and January. In 1926 the almost complete collapse of the Louisiana sugar industry made it necessary for the company to import its fiber from Cuba at a much higher cost. To prevent a recurrence of this situation, the president of the Caneboard Company and his associates organized the Gulf Sugar Company of Louisiana. In 1928 the Caneboard Company contracted to purchase for 15 years from the Gulf Sugar Company the latter's entire output of cane pulp. In payment, the Caneboard Company was to meet the interest requirements on a 6½% bond issue of $1,250,000 and the dividends on the 7% preferred stock of $1,250,000 of the Gulf Sugar Company. During the next three years the Caneboard Company invested over $2,000,000 in this affiliate, an investment which was reduced to $1 on the books of the Caneboard Company in 1931. In July, 1930, receivers were appointed for the Gulf Sugar Company; the company was reorganized and reincorporated in 1931.

In 1930 two suits for the appointment of a receiver for the Caneboard Company were filed by stockholders on the grounds of insolvency, mismanagement, and misappropriation of funds. These suits and a suit filed in May, 1932, alleging that the management was incompetent and criticizing the advances of $2,000,000 to the Gulf Sugar Company, were dismissed.

Finally in June, 1932, the Federal court in Delaware appointed receivers for the company on a plea filed by a trade creditor. The receivership bill stated that, although assets exceeded liabilities, the corporation had insufficient cash on hand to meet maturing obligations. In consenting to receivership appointments, officials stated that the difficulties were the result of a greatly reduced volume of business ascribable to the depression. Under the court order the receivers were authorized to continue operation of the company in order that manufacture, sale, and trade relations might be maintained without interruption and customers served as in the past. The financial position of the Caneboard Company is further described in Exhibits 1–5, pages 349–353.

1. What were the chief causes of the company's difficulties and to what extent could they be removed or minimized by reorganization?

2. Present a complete plan for a financial reorganization of the company which would be equitable to all groups interested.

3. Prepare a pro forma balance sheet giving effect to the reorganization plan proposed.

EXHIBIT 1
CANEBOARD COMPANY
BALANCE SHEET, AS OF OCTOBER 31

Item	1929	1930	1931
ASSETS			
Cash	$ 635,367	$ 374,053	$ 420,747
Notes and Accounts Receivable, Less Reserves	2,141,453	1,509,333	1,023,736
Inventories at or below Cost	1,069,394	1,098,708	1,314,979
Advances to Affiliates	416,820		
Total Current Assets	$ 4,263,034	$ 2,982,094	$ 2,759,462
Cash Surrender Value of Life Insurance	31,760	30,050	
Capital Stock Subscriptions	1,004,826	18,749	
Treasury Stock	2,280		
Investments	110,380	228,067	
Plant and Equipment, Less Depreciation	6,141,682	5,625,104	5,264,625
Patents and Patent Rights	5,225,000	6,203,741	3,500,199
Deferred Charges and Prepaid Expenses	399,925	135,644	184,396
The Gulf Sugar Company—Deferred Advances	1,489,421	1,905,645	1
Total Assets	$18,668,308	$17,129,094	$11,708,683
LIABILITIES			
Notes Payable	$ 1,175,000	$ 10,000	
Accounts Payable	1,109,206*	660,683	$ 131,344
Advances Secured by Accounts Receivable	....	....	219,031
Accrued Liabilities	84,206	191,702	185,760
Provision for Sinking Fund	....	164,200	123,500
Provision for Local and Federal Taxes	253,154	117,808	117,808
Total Current Liabilities	$ 2,621,566	$ 1,144,393	$ 777,443
First Mortgage Bonds, 6½%, Due 1939	1,004,500	869,800	809,500
Debentures, 6%, Due 1936	1,900,000	1,700,000	1,600,000
Preferred Stock, 7% Cumulative	5,321,000	5,326,600	5,303,000
Common Stock, No Par	6,274,941	7,321,550	1,382,550
Appreciation from Appraisal of Plant	353,609		
Capital Surplus	....	68,342	1,268,381
Earned Surplus	1,192,692	698,409	567,809
Total Liabilities	$18,668,308	$17,129,094	$11,708,683

* Includes accrued liabilities.

EXHIBIT 2
CANEBOARD COMPANY
INCOME ACCOUNT, YEARS ENDED OCTOBER 31

Item	1929	1930	1931	1932*
Sales....	$10,317,640	$8,557,634	$5,953,405	$3,005,785
Manufacturing, selling, and administrative expenses..............	7,697,483	7,560,468	5,426,951	3,567,370
Income, before interest, taxes, and depreciation	$ 2,620,157	$ 997,166	$ 526,454	$ 561,585[d]
Other income..........	91,207	20,332	114,768	86,780
Total income.......	$ 2,711,364	$1,017,498	$ 641,222	$ 474,805[d]
Special rebates.........	355,685			
Loss in foreign exchange.	.. ..	....	50,000	23,117
Interest and debt expense	275,973	255,449	227,300	201,319
Provision for Federal income taxes..........	182,000	38,000		
Depreciation...........	419,116	479,970	494,522	463,661
Total deductions....	$ 1,232,774	$ 773,419	$ 771,822	$ 688,097
Net profit.... ...	$ 1,478,590	$ 244,079	$ 130,600[d]	$1,162,902[d]†

* Including receivers' accounts from June 16.
† Before extraordinary adjustments (net $219,825) as at date of receivership and before provisions for services of receivers.
[d] Deficit.

EXHIBIT 3
CANEBOARD COMPANY
(IN RECEIVERSHIP)
COMBINED BALANCE SHEET

Item	Oct. 31 1932	Jan. 31 1934
Assets on the Books of Receivers:		
Current Assets:		
Cash	$ 141,720	$ 207,920
Accounts and Notes Receivable, Less Reserves	539,665	656,604
Inventories, at or below Cost	910,721	701,643
Total Current Assets	$ 1,592,106	$ 1,566,167
Prepaid Interest, Insurance, etc.	14,410	49,493
Investments and Advances	121,569	139,237
Plant and Equipment Less Depreciation as at Date of Receivership	4,930,680	4,958,427
Patents and Patent Rights	3,500,199	3,500,199
Sinking Funds	1,896	1,825
Total Assets on Books of Receivers	$10,160,860	$10,215,348
Assets on the Books of the Caneboard Company:		
Sinking Funds	12,884	12,884
Deferred Charges	78,111	56,658
Total Assets on Books of Caneboard Company	$ 90,995	$ 69,542
Total Assets	$10,251,855	$10,284,890
Current Liabilities on Books of Receivers:		
Accounts Payable—Trade	$ 41,517	$ 89,299
Advances against Accounts Receivable	97,677	82,779
Accrued Wages, Commissions, etc.	26,906	32,687
Accrued General Property Taxes	22,457	104,295
Reserve for Advertising	8,380	
	$ 196,937	$ 309,060
Current Liabilities on Books of the Caneboard Company as at Date of Receivership, Less Subsequent Net Changes:		
Notes and Accounts Payable	177,242	161,259
Accrued General Property Taxes	79,995	35,979
	$ 257,237	$ 197,238
First Mortgage Bonds, 6½%, Due 1939	821,500	821,500
Interest Accrued on First Mortgage Bonds since June 1, 1932	22,276	88,996
Debentures, 6%, Due 1936	1,600,000	1,600,000
Interest Accrued on Debentures	47,910*	12,244†
Reserve for Depreciation, Provided since June 16, 1932	166,983	715,808
Preferred Stock	5,303,000	5,303,000
Common Stock	1,382,550	1,382,550
Capital Surplus	1,268,380	1,268,380
Earned Surplus	814,919[d]	1,413,886[d]
Total Liabilities	$10,251,854	$10,284,890

* May 1 to October 31, 1932.
† May 1 to June 16, 1932.
[d] Deficit.

EXHIBIT 4

CANEBOARD COMPANY

(IN RECEIVERSHIP)

COMBINED STATEMENT OF PROFIT AND LOSS,

YEAR ENDED OCTOBER 31, 1933

RECEIVERS' ACCOUNTS	
Sales	$2,936,200
Manufacturing, selling, and administrative expenses	2,947,099
Loss, before depreciation	$ 10,899
Other income	49,421
Total income	$ 38,522
Interest, chargeable to receivers	23,639
Payments for receivers' services	66,000
Net loss, before depreciation	$ 51,117
CORPORATION'S ACCOUNTS	
Interest and debt expense	$ 171,006
Depreciation	441,999
Total	$ 613,005
Net combined loss of receivers and corporation	$ 664,122

Exhibit 5
Caneboard Company
Information regarding Securities

1. First mortgage convertible 15-year 6½% sinking fund gold bonds, Series A; due December 1, 1939.

Interest payable June and December 1, in default since June 1, 1932.

Authorized amount of mortgage	$20,000,000
Authorized amount of Series A	$ 1,250,000
Issued, $1,250,000 Series A, of which retired to January 31, 1934	$ 428,500

Callable on any interest date at 105 and interest to December 1, 1929, premium diminishing thereafter ½ of 1% per annum.

Sinking fund beginning December 1, 1926, will retire semiannually 3½% of the outstanding bonds.

Convertible at any time before December 31, 1934, into 7% preferred stock par for par.

Secured by a first lien on all fixed assets and patents, owned or hereafter acquired.

2. Ten-year convertible sinking fund 6% gold debentures; due November 1, 1936.

Interest payable May and November 1, in default since May, 1932.

Authorized amount unlimited. Issued $2,000,000 of which $400,000 redeemed to January 31, 1934.

Callable on any interest date to November 1, 1927, at 103 and interest thereafter ¼ of 1% each year to November 30, 1935, and at par thereafter.

Sinking fund to retire on May 1, 1929, and each year thereafter $100,000 par value per annum.

Convertible to November 30, 1935, into preferred and common stock on a basis of eight shares of preferred and two shares of common for each $1,000 bond.

Not secured by a mortgage, but a direct obligation of the company.

3. Preferred stock 7% cumulative, par $100.

Dividends payable January, April, July, October 1; none paid since July 1, 1930.

Outstanding January 31, 1934, 53,030 shares.

Callable at 110 per share and accrued dividends.

Preferred as to cumulative dividends and as to assets in liquidation.

4. Common stock, no par.

Outstanding, January 31, 1934, 276,510 shares.

Dividends not paid since April 1, 1930.

5. CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY[1]

REORGANIZATION

On March 18, 1925, the Binkley Coal Company, a friendly creditor, petitioned that the Chicago, Milwaukee & St. Paul Railway Company be placed in the hands of receivers.

The Chicago, Milwaukee & St. Paul Railway Company, the Great Northern Railway Company, and the Northern Pacific Railway Company were the three large roads which served the northwestern section of the country from Chicago to the Pacific coast. Since 1916 these three lines had had a greater decline in return than had all railroads throughout the country. The rate of return for all roads had declined from 5.59% in 1916 to 4.73% in 1925, while for the northwestern roads it had declined from 5.68 to 3.50%. Among the reasons responsible for this difference were the small spread between costs and rates for the northwestern roads as compared with the rest of the country, the agricultural depression in the Northwest, the collapse of trade with Russia and China, the cessation of immigration to the Northwest, and the competition from the Panama Canal and from automobiles. Of the three large northwestern roads, the Chicago, Milwaukee & St. Paul Railway Company was in the weakest position so that it was to be expected that it should be the first of these three to suffer.

The Chicago, Milwaukee & St. Paul Railway Company originally served the territory directly northwest of Chicago and was classified as one of the "granger" roads. As the natural resources of the territory, for example, the pine forests of Wisconsin and northern Michigan, gradually became depleted, the management of the road sought other sources of freight to carry to the terminal cities, Chicago and Milwaukee. The Pacific Northwest seemed particularly attractive, especially if a line were built through to a terminus on Puget Sound. The company believed that such a road would obtain traffic from the great lumber regions, the excellent harbors at Seattle and Tacoma, the Orient, Alaska, the fisheries of the Pacific coast, the grain and fruit industries of Washington, the rapidly increased population, the great mining districts of Montana and Idaho, and the sheep and

[1] Adapted from C. E. Fraser, *Problems in Finance*, 2d rev. ed., McGraw-Hill Book Company, Inc., New York, 1930.

cattle raising industry throughout most of the territories served. Since a number of other railroads were considering using part of the right of way which the Chicago, Milwaukee & St. Paul Railway Company intended to employ, the latter company decided to lose no time and accordingly in 1905 built the extension to the Pacific coast.

It later proved that the territory served could not support three railroads; the other two roads were firmly established and had feeder lines, while lines of the Chicago, Milwaukee & St. Paul Railway Company extended for long distances through territory from which little freight traffic was obtained. In addition, the cost of construction of the line to the Pacific coast had far exceeded estimates. Since bonds rather than stock had been issued to finance this expansion, the company had a heavy capital structure of bonded indebtedness. A comparison of the capital structure of the Chicago, Milwaukee & St. Paul Railway Company for different years follows:

(In thousands of dollars)

Item	June 30, 1909		Dec. 31, 1917		Dec. 31, 1920		Dec. 31, 1924	
Funded debt.	$115,765	29%	$383,041	59%	$412,315	60%	$443,983	64%
Preferred stock	115,932	29	115,932	18	115,932	17	115,932	17
Common stock	115,946	29	117,411	18	117,411	17	117,411	17
Surplus.......	47,961	13	30,975	5	39,073	6	16,694	2
Total......	$395,604	100%	$647,359	100%	$684,731	100%	$694,020	100%

Exhibit 1 shows the classification of freight of the Chicago, Milwaukee & St. Paul Railway Company for the years 1920 to 1924.

The management of the Chicago, Milwaukee & St. Paul Railway Company had been prodigal in the payment of dividends. In the period 1908 to 1917, inclusive, of a total net income of $146,245,000, $141,723,000 had been paid in dividends. Between 1916 and 1920, 648 miles of line over the mountains were electrified; whether this improvement was extravagant was the subject of much debate. Proponents of the plan claimed that from 1916 to 1924 approximately three-fourths of the cost of electrification was saved by operating economies, but in this estimate they made no allowance for carrying charges for the project.

Early in 1925, therefore, the Chicago, Milwaukee & St. Paul Railway Company was in good physical condition, but its financial position was weak and its outlook for an immediate increase in earnings was poor. The situation also was aggravated by unfavorable rate decisions of the Interstate Commerce Commission.

EXHIBIT 1
CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY
CLASSIFICATION OF FREIGHT, YEARS ENDED DECEMBER 31

Item	1920	1921	1922	1923	1924
Revenue freight moved (tons)	45,041,277	34,067,136	42,034,285	51,314,300	47,143,747
Products of:					
Agriculture	15 2 %	19.8 %	17.6 %	16.0 %	16.5 %
Animals	4.9	6 1	5.5	5.1	5.5
Mines	34 7	33.7	33 9	36.3	34.0
Forests	20 0	17.9	20.1	21.3	21.5
Manufactures and miscellaneous	19 5	17.4	18 5	17.8	18.6
Commodities not specified	5 7	5 1	4.4	3.5	3 9
Totals	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %

The capitalization of the Chicago, Milwaukee & St. Paul Railway Company was approximately two-thirds bonds and one-third stock. A comparison of fixed charges and earnings available to meet these charges follows:

Year	Fixed charges	Earnings available for fixed charges
1921	$16,960,000	$ 3,712,000
1922	18,073,000	12,076,000
1923	19,444,000	19,793,000
1924	20,448,000	18,718,000

In addition to the $20,448,000 of fixed charges for 1924, in 1925 $8,115,333 would be required for the 7% dividend on the preferred stock outstanding. In a survey and valuation of the property of the railroad, the engineering firm of Coverdale and Copitts estimated that an average annual expenditure of $7,294,000 for additions and betterments and $10,286,000 for new equipment and additions to existing equipment should be made for the next ten years. Besides the already existing fixed charges, the road soon would become liable for additional charges, among them being approximately $800,000 yearly in connection with the new Chicago Union Station, which had just been completed

at the time of the receivership. During 1925, maturing bonded indebtedness of $52,840,896 would have to be paid or refinanced. The Chicago, Milwaukee & St. Paul Railway Company was unable

EXHIBIT 2
CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY
BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1920	1921	1922	1923	1924
ASSETS					
Cash	$ 8,088	$ 7,730	$ 5,682	$ 5,787	$ 7,844
Special Deposits	1,659	1,389	21,578	18,003	14,713
Materials and Supplies	20,490	15,480	13,330	15,215	13,575
Other Working Assets	21,616	11,179	10,588	9,787	8,799
Total Working Assets	$ 51,853	$ 35,778	$ 51,178	$ 48,792	$ 44,931
Road and Equipment	659,519	665,340	675,238	693,192	696,425
Investment in Affiliated Companies	27,377	27,426	11,498	14,687	13,182
Other Investments	2,385	2,623	2,206	570	546
Deferred Assets	3,462	3,559	3,960	3,790	3,559
Unadjusted Debit Items	4,278	3,171	2,924	3,105	3,591
Total Assets	$748,874	$737,897	$747,004	$764,136	$762,234
LIABILITIES					
Bills Payable	$ 1,000	$ 2,576	$ 1,395	$ 5,000	
Traffic and Car Service Balance	4,090	2,139	3,401	2,696	$ 2,463
Payrolls and Vouchers	23,004	14,507	17,520	20,932	16,110
Matured Interest Unpaid	2,410	1,631	5,568	4,420	4,830
Matured Funded Debt	41	123	17	13	12
Interest Accrued on Funded Debt	5,618	5,949	2,974	3,210	3,084
Unmatured Rents Accrued	......	312	526	563	645
Total Working Liabilities	$ 36,163	$ 27,237	$ 31,401	$ 36,834	$ 27,144
Deferred Liabilities	893	365	614	512	158
Accrued Taxes and Reserves	9,187	13,028	13,087	12,676	12,708
Accrued Depreciation—Equipment	17,865	20,728	23,222	25,054	28,130
Reserves (from surplus)	696	991	934	1,027	1,283
Common Stock	117,411	117,411	117,411	117,411	117,411
Preferred Stock	116,275	116,275	116,275	116,275	116,275
Premiums on Stock	36	36	36	36	36
Total Capital Stock	$233,722	$233,722	$233,722	$233,722	$233,722
Less Stock Held by Company	343	343	343	343	343
Capital Stock Balance	$233,379	$233,379	$233,379	$233,379	$233,379
Grants in Aid of Construction	....	27	33	37	38
Mortgage Bonds	493,118	504,648	504,636	503,732	516,500
Equipment Gold Notes	16,445	14,252	22,327	35,728	32,700
U. S. Government Notes	20,000	55,340	55,000	55,000	55,000
Total Funded Debt	$529,563	$574,240	$581,963	$594,460	$604,200
Less Bonds Held by Company	117,248	160,257	160,258	160,217	160,217
Balance	$412,315	$413,983	$421,705	$434,243	$443,983
Profit and Loss Surplus	38,376	28,159	22,629	20,374	15,411
Total Liabilities	$748,874	$737,897	$747,004	$764,136	$762,234

either to pay or to refinance such an amount, as evidenced by the balance sheets and income statements which are shown in Exhibits 2 and 3. Some remedial action had to be taken.[1]

[1] About the same time the New York, New Haven & Hartford Railroad Company was in somewhat similar difficulties and succeeded in refunding a portion of its securities by selling $23,000,000 of 6% bonds chiefly to officers, customers, and

Kuhn, Loeb & Company and the National City Company became reorganization managers in March, 1925, and, in collaboration with the three committees which were formed to represent the holders of the defaulted bonds, the preferred stock, and the common stock, respectively, devised a plan of reorganization. It was believed that any plan should accomplish five results: (1) fund all early maturing debts, including the debt to the government, into long-term obligations junior in lien to

EXHIBIT 3
CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY
INCOME ACCOUNT, YEARS ENDED DECEMBER 31
(In thousands of dollars)

Item	1920	1921	1922	1923	1924
Average miles operated	10,624	10,809	11,029	11,010	10,986
Freight revenues	$117,184	$104,895	$116,006	$127,953	$120,070
Passenger revenues	31,034	26,915	24,262	24,176	21,768
Miscellaneous revenues	19,941	14,956	16,683	17,499	16,528
Total operating revenues	$168,159	$146,766	$156,951	$169,628	$158,366
Total operating expenses	164,697	127,957	129,597	134,999	125,550
Net revenues from operation	$ 3,462	$ 18,809	$ 27,354	$ 34,629	$ 32,816
Gross income	12,068[d]	8,922	14,859	21,879	20,748
Total deductions	2,990	1,117	1,932	2,085	2,028
Balance for funded debt interest	$ 15,058[d]	$ 7,805	$ 12,927	$ 19,794	$ 18,720
Interest on funded debt	17,594	18,768	18,927	19,444	20,448
Applied to sinking funds	138	108	143	142	141
Net income	$ 32,790[d]	$ 11,071[d]	$ 6,143[d]	$ 208	$ 1,869[d]
Times funded debt interest earned	Nil	0.42	0.68	1.02	0.92
Earnings per share:					
Preferred	Nil	Nil	Nil	0.18	Nil
Common	Nil	Nil	Nil	Nil	Nil

[d] Deficit.

the new mortgage; (2) reduce fixed charges radically and set up a financial structure under which new funds could be raised at reasonable cost so that a repetition of even the conditions of the past few years might occur without risk of a second failure; (3) apply all earnings reasonably available, after making these provisions, to the payment of 5% interest on the bonds included in the reorganization; (4) maintain the relative position of bondholders and stockholders in respect to earnings and admit stock-

friends of the road. This plan was suggested for the Chicago, Milwaukee & St. Paul Railway Company but there were several marked differences in the situation. The Chicago, Milwaukee & St. Paul Railway Company was confronted by a series of maturities which amounted to $239,957,396 for the next 10 years. Again, the Chicago, Milwaukee & St. Paul Railway Company covered a large area, was confronted with heavy competition, and had little hold on the sympathies of the populace in the territory through which its lines extended, while the reverse was true for the New York, New Haven & Hartford Railroad Company.

holders on such a basis that their participation, if necessary, could be underwritten at a moderate expense; (5) raise cash by some means, probably by assessment of the stockholders.

EXHIBIT 4

CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY

SUMMARY OF OBLIGATIONS, MARCH, 1925

To be left undisturbed:		
Obligations of the Chicago, Terre Haute & Southeastern Railway Co		$ 22,096,400
Equipment trust certificates		30,942,000
General mortgage bonds		100,547,000
Security gold mortgage loan of 1924		14,000,000
Divisional bonds		10,785,000
Chicago, Milwaukee, and Gary first mortgage bonds		3,000,000
Total undisturbed obligations		$181,370,400
To be paid:		
Obligations to U. S. Government—		
6% notes secured by bond issues		$ 55,000,000
Other obligations to be liquidated—timber loan		2,200,000
Total obligations to be paid		$ 57,200,000
To be exchanged for new securities:		
Refunding mortgage bonds, due January 1, 2014:		
Series A 4½% bonds	$ 43,089,000	
Series B 5% bonds	29,141,300	
Series Z 6% bonds	117,217,200	
Total refunding mortgage bonds	$189,447,500	
Deduct $72,829,000 pledged under U. S. Government notes and $44,388,200 held in treasury	117,217,200	$ 72,230,300
4% bonds, due 1925		36,344,981
European loan bonds (other than bonds pledged under 4% bonds)		11,831,515
4½% bonds, due 1932		50,000,000
4% bonds, due 1934		33,369,000
Puget Sound bonds, due January 1, 1949	$181,664,500	
Including bonds pledged under refunding mortgage	154,489,500	27,175,000
Total obligations to be exchanged		$230,950,796
Total of all obligations of company		$469,521,196

Exhibit 4 gives the summary of obligations of the railroad prepared by Kuhn, Loeb & Company. The capitalization under three plans of reorganization suggested was as shown in Exhibit 5. All these plans were in agreement on the following items:

1. $181,370,400 of existing senior obligations were to remain undisturbed, since their claim was so secure that, if the substitution of junior securities were attempted, the bondholders could take possession of the road to satisfy their own claims.

2. A new first and refunding mortgage was to be created, for *future financing only*, to rank immediately behind the undisturbed bonds.

3. $230,950,796 of existing junior obligations were to be exchanged for new "adjustment" bonds, more fully described below.

Under the original plan of Kuhn, Loeb & Company, new money was to be obtained, largely to pay off $55,000,000 of notes held by the United States Government, through an issue of 50-year 5%

EXHIBIT 5

CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY

COMPARISON OF CAPITALIZATION UNDER THE PROPOSED PLANS FOR REORGANIZATION

Item	Old capitalization	First Kuhn, Loeb plan	Roosevelt plan	Modified Kuhn, Loeb plan
Undisturbed obligations		$181,370,400	$181,370,400	$181,370,400
To be liquidated		57,200,000	7,200,000	57,200,000
To be exchanged for new securities		230,950,796	280,950,796	230,950,796
Additional fixed interest bonds and notes to be issued				
a. In connection with assessment of preferred stock		27,823,656		27,823,656
b. In connection with assessment of common stock		32,875,164		32,875,164
c. With new adjustment mortgage bonds in exchange for old bonds			57,737,699	46,190,160
d. For government notes			50,000,000	
Total fixed interest bonds and notes outstanding	$469,521,196	$242,069,220	$289,108,099	$288,259,380
Adjustment mortgage bonds to to be issued for:				
Old bonds		230,950,796	173,213,097	184,760,640
Assessed preferred and common stock			23,334,320	
Preferred stock	115,931,900	115,931,900	115,931,900	115,931,900
Common stock	117,411,300	117,411,300	117,411,300	117,411,300
Total capitalization	$702,864,396	$706,363,216	$718,998,716	$706,363,220
Charges:				
Total fixed	$ 21,836,793	$ 11,466,845	$ 12,991,412*	$ 13,776,353
Adjustment mortgage bonds (if earned)		11,547,540	9,827,371	9,238,032
Preferred stock	8,115,233	5,796,595	5,796,595	5,796,595
Common stock	5,870,565	5,870,565	5,870,565	5,870,565
Total charges	$ 35,822,591	$ 34,681,545	$ 34,485,943	$ 34,681,545

* This amount to be increased by $577,377 after five years, when the proposed 50-year mortgage bonds were to bear 5% instead of 4% interest.

mortgage gold bonds which would rank next below the first and refunding mortgage and for which the existing stockholders would be required to subscribe as a condition of retaining an interest in the reorganized company. Below these was to come the new issue of 5% convertible adjustment mortgage bonds for which the existing junior obligations were to be exchanged. Interest

on these adjustment bonds was to be paid only out of earned net income; they were to be convertible into preferred and common stock at the ratio of five shares of preferred and five shares of common for each $1,000 bond, with suitable adjustment of interest and dividends. The holders of the 7% preferred stock were to be assessed $28 a share. They were to receive in exchange for their stock one share of new 5% noncumulative preferred stock, par $100, and for the $28 assessment $24 in the 50-year 5% mortgage gold bonds referred to above. The holders of the common stock were to be assessed $32. In return for surrendering their old shares and paying this assessment, they were to receive one share of new common and $28 of the 5% mortgage gold bonds. The new preferred stock was to receive dividends of $5 a share; then the common was to receive dividends of $5 a share, after which all subsequent earnings disbursed were to be divided equally between them.

The Roosevelt plan, which was presented by Roosevelt and Son, investment bankers, provided for giving the holders of the $230,950,796 of junior obligations, listed in the third section of Exhibit 4, 25% in 50-year fixed interest bonds ranking immediately junior to the new first and refunding mortgage bonds created by both this plan and that of Kuhn, Loeb & Company for future financing only, and 75% in 5% adjustment bonds. The latter bonds were to receive an additional 1% when the new preferred received more than 4% in dividends but were otherwise similar to the adjustment bonds provided for in the Kuhn, Loeb & Company plan. The Roosevelt plan reduced the amount of new money required by proposing to pay off only $5,000,000 of the notes due the government and to refund the balance at 4½% for serial payment over 15 years, beginning in the fourth year after the reorganization, provided Congress gave its consent. The reduced cash requirements were to be met by a $10 assessment on each share of preferred and common stock, and for the $23,334,320 thus obtained the stockholders were to receive dollar for dollar in the new adjustment mortgage bonds.

The modified plan of Kuhn, Loeb & Company was prepared at the insistence of insurance companies and savings banks, which wished new fixed-interest-bearing securities in exchange for those they surrendered. The treatment of preferred and common stockholders was the same as under the original plan of Kuhn, Loeb & Company, but the holders of the junior obligations were to

exchange them for $200 of the 5% mortgage gold bonds (the same that were given to stockholders in exchange for their assessment) and $800 of the convertible adjustment mortgage bonds.

The plan published by the Roosevelt Committee stated:

> The Roosevelt committee serves without compensation. The expenses of reorganization upon the consummation of the plan shall be passed upon by the Interstate Commerce Commission and shall be paid out of reorganization funds.

If the Roosevelt plan were adopted it was expected that Roosevelt and Son would underwrite the new securities and therefore receive a commission.

Under the Kuhn, Loeb & Company plans the reorganization managers might take as compensation $1,044,063 and a further sum not exceeding $2,456,085 for the compensation of committees and depositaries and for expenses other than those of receivership and foreclosure. The Roosevelt plan gave voting control for the first three years, during which interest on the adjustment bonds was to be noncumulative, to holders of such bonds, who would thus determine what proportion of income available for the adjustment bond interest they should pay to themselves. The Kuhn, Loeb & Company plan kept the voting power in the hands of stockholders and provided a five-year voting trust.

1. Which of the plans suggested should have been adopted?
2. Should the bondholders have allowed the stockholders to retain an equity in the new capitalization?

appeared inevitable in view of the depleted cash resources of operating companies following the continuous and severe decline of operating revenues. The state of the financial markets as a result of the bank holiday made refunding all but impossible. The short-term outlook as to earnings clearly indicated that interest charges could not be met. A consent receivership was decided upon by the board of directors in order to conserve the assets of the company. On April 1, 1933, default occurred on both principal and interest due on the 6% secured gold notes, and on interest due on the 15-year 5% debentures, Series B. Application for a receiver was then made by a noteholder. The Court of Chancery in Delaware appointed Christopher L. Ward, Jr., and William J. Wardall, the president of the company, as receivers. A month later, default occurred on the interest payment upon the $21,007,500 of 5½% convertible gold debentures, Series C.

Associated Telephone Utilities Company (hereafter referred to as ATU), incorporated in Delaware in 1926, was the top holding company for a group of intermediate holding companies and operating properties which, by the end of 1932, constituted a system spread over 25 states from New York to California. At the time of receivership, the ATU group comprised 42 operating companies, 8 holding companies, and 1 company engaged in the telephone-directory business. The usual method of financing the expansion was for ATU to acquire, directly or indirectly by the issue of its own securities, the stocks, bonds, notes, and other obligations and securities of operating companies or intermediate holding companies. By March 31, 1933, $49,094,411.44 was invested in securities of subsidiary companies, of which amount about one-third was in securities and accounts receivable of subsidiary holding companies, each with interest-bearing obligations of its own.

After giving effect to the elimination of all investments in its three subsidiaries which had been placed in receivership or bankruptcy, with the exception of $175,000 principal amount of first lien collateral 5½s of the Indiana Central Telephone Company, the balance sheet of ATU, as of March 31, 1933, carried[1] investments in subsidiaries, $39,056,435; current assets, $753,115; current liabilities, $4,974,122; and total assets, $43,074,889. A comparative consolidated income account for two four-month

[1] Condensed from Moody's *Public Utilities*, 1933.

periods ending April 30, 1932, and 1933, was preparea by the receivers. After giving effect to the elimination of the income accounts for the same subsidiaries as above, and including the earnings for the same properties in each of the two four-month periods, the statement showed net income as follows[1]:

Item	1932	1933
Total operating revenues	$4,142,643	$3,602,359
Net earnings	1,261,396	1,056,033
Balance applicable to ATU	671,303	374,416
Net income	59,977	224,880[d]

[d] Deficit.

The rapid growth of the system is shown in the following table:

Year	Gross revenue*	Number of exchanges	Number of telephones	Number of states
1926	$ 405,032	11	38,074	3
1927	3,193,629	142	101,923	8
1928	5,191,742	221	156,001	7
1929	12,544,779	656	378,164	20
1930	15,914,784	754	454,325	22
1931	17,711,728	943	497,688	25
1932	15,810,734	930	437,529	25

* Includes full 12 months' earnings of properties owned at the end of each calendar year, except that for the year 1926 the earnings of only the last 4 months are included.

In common with other telephone companies, the ATU group suffered a marked decline in gross revenue and in the number of stations served, particularly after 1931. Balance sheets and operating statements of the company are given in Exhibits 1 and 2. As Exhibit 2 indicates, both the gross and the net income of the company declined appreciably after 1931. The gross operating revenue for the first quarter of 1933 was $4,641,806, and later incomplete reports indicated a further decline. Since efforts were made to maintain standards of telephone service, adjustments in expense only partially offset the shrinkage in gross revenue. Threatened taxes and increased agitation for reduced rates increased the difficulties. Income available for service on the

[1] Condensed from Moody's *Public Utilities*, 1933.

EXHIBIT I
ASSOCIATED TELEPHONE UTILITIES COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1926	1927	1928	1929	1930	1931	1932	1932*
ASSETS								
Plant, Franchises, etc.	$6,468	$18,178	$34,214	$76,371	$101,556	$116,428	$110,874†	$81,827†
Investments in Subsidiaries in Bankruptcy or Receivership‡	......	....	......	......	....	....	....	3,695
Ind. Cen. Tel. Co.—$175,000 1st Lien Coll. 5½'s and Interest (Cost)	......	....	......	......	....	....	....	157
Insurance Fund Investments (Cost)	......	....	......	......	....	183	216	216
Other Investments (Cost)	12	187	177	6,539	1,133	598	308	299
Treasury Stock (Cost)	......	....	......	......	3,262			
Received on Subscriptions	......	....	......	......	....	232		
Stock Loaned to Officers	......	....	......	......	....	640		
Current Assets:								
Cash and Working Funds	251	430	652	1,590	2,148	2,015	2,184	1,720
U. S. Government Securities	......	....	......	......	....	......	56	
Accounts and Notes Receivable, Less Reserve	73	157	330	818	844	1,095	816	599
Subscriptions to Subsidiary Companies' Preferred Stock	......	....	118	137	273	165	81	66
Materials and Supplies	123	334	637	1,335	1,598	2,015	1,968	1,245
Sinking Fund and Other Special Deposits	......	95	48	124	798	182	54	14
Unamortized Debt Discount and Expenses	176	698	794	1,749	3,357	4,948	5,626	4,544
Prepayments	......	....				165	161	120
Amortized Rate Case Expense	......	44	114	425	425	192	164	112
Miscellaneous Deferred and Unadjusted Items	9	57				291	306	233
Unbilled Toll Revenues	......	80	26					
Total Assets	$7,112	$ 20,260	$37,110	$89,088	$115,394	$129,149	$122,814	$94,847
LIABILITIES								
$7 Prior Preferred Stock§	$1,026	$ 1,630	$ 1,755	$ 1,789	$ 1,789	$ 4,577	$ 4,569	$ 4,569
$6 Prior Preferred Stock§	.....	2,300	2,400	2,510	2,480	2,709	2,582	2,582
$6 Preferred Stock§	.....	....	......	4,750	4,750	4,750	4,514	4,514
Common Stock§	1,615	2,139	8,153	17,115	7,825	8,624	6,195	6,195
Common Scrip	......	....	......	......	33	36	52	52
Subscription to Treasury Stock	......	....	......	......	....	197		
Preferred Stock of Subsidiaries (Public)	...	300	2,874	8,362	8,479	8,923	8,714	8,280
Minority Interest	232	243	353	493	738	660	646	421
Funded Debt of ATU Co.	1,484	3,130	5,005	9,573	23,573	28,427	24,802	24,802
Funded Debt of Subsidiaries	1,894	6,936	10,871	25,653	32,104	41,349	44,026	29,377

EXHIBIT I (*Continued*)
ASSOCIATED TELEPHONE UTILITIES COMPANY
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31
(In thousands of dollars)

Item	1926	1927	1928	1929	1930	1931	1932	1932*
Current and Accrued Liabilities:								
Dividends Accrued	$ 16	$ 24	$ 126	$ 120	$ 111	$ 144	$ 80	$ 79
Brokers' Loans	......	......	......	......	......	637		
Notes Payable (Secured)	......	......	639	814	66	1,650	486	476
6 % Gold Note Due April 1, 1933	......	......	......	......	......	......	3,858	3,858
Due Central Tel. Co. in Bankruptcy‖	......	......	......	......	......	......	......	248
Accounts Payable	79	614	358	1,178	1,313	1,011	876	723
Accrued Interest	87	171	244	462	688	811	884	728
Taxes Accrued (Including Federal)	78	217	333	730	858	1,047	1,119	853
Other Current Liabilities	7	98	19	136	113	203	37	31
Stock Dividend Payable	......	......	......	102	129	118		
Purchase Obligations	......	......	......	4,794				
Obligations of Subsidiary	......	......	......	500	500	500		
Temporary Loan	......	......	......	......	2,625			
Liability on Securities Called	......	......	......	......	685			
Depreciation Reserve	460	2,042	2,806	8,085	10,353	11,366	11,545	8,388
Contributions for Extensions	......	......	......	......	361	344	361	342
Other Reserves	9	36	317	183	157	272	365	349
Deferred Liabilities	......	32	111	158	78	88	62	53
Capital Surplus	87	87	235	713	14,108	9,185	5,673	2,073[d]
Earned Surplus	38	261	511	868	1,478	1,521	1,368	
Total Liabilities	$7,112	$20,260	$37,110	$89,088	$115,394	$129,149	$122,814	$94,847

* Pro forma consolidated balance sheet after giving effect to the elimination of assets and liabilities of Standard Telephone Company and subsidiaries and Central Telephone Company and subsidiaries, and the elimination of all investments in Standard Telephone Company, Central Telephone Company, and Indiana Central Telephone Company, with the exception of $175,000 principal amount of first lien collateral 5½ % gold bonds of latter company, such companies having been placed in receivership or bankruptcy since December 31, 1932.

† Including $17,996,244 before eliminations and $14,261,376 after eliminations, representing excess of investments in securities of operating subsidiary companies over the underlying book value thereof at dates of acquisition.

‡ Consists of preferred stocks ($3,526,386) and bonds ($41,278) and receivables from operating companies which are subsidiaries of the subsidiary holding companies placed in receivership or bankruptcy since December 31, 1932.

§ Represented by no par shares:

$7 prior preferred	45,692 shares
$6 prior preferred	27,921
$6 preferred	47,517
Common	619,448.108

‖ Represented by $824,833 note including accrued interest, offset (subject to determination by the Bankruptcy Court) by $571,000 debentures of that company plus $5,711 accrued interest thereon.

[d] Deficit

Compiled from Moody's *Public Utilities*.

EXHIBIT 2

ASSOCIATED TELEPHONE UTILITIES COMPANY

CONSOLIDATED INCOME ACCOUNT, YEARS ENDED DECEMBER 31

(Including earnings of subsidiaries acquired, for period since dates of acquisition only)

Item	1929	1930	1931	1932	1932*
Gross operating revenue	$8,845,181	$15,559,445	$17,358,465	$15,739,828	$11,955,990
Operating expenses	2,856,985	5,277,539	5,817,318	5,436,515	3,972,474
Maintenance	1,266,219	2,366,059	2,567,793	2,386,524	1,824,144
Taxes (including Federal income)	655,320	945,394	1,177,943	1,199,656	864,551
Depreciation	925,659	1,451,095	1,743,987	2,004,112	1,641,650
Net earnings	$3,140,998	$ 5,519,358	$ 6,051,424	$ 4,713,021	$ 3,653,171
Other income	51,588	65,762	43,767	50,271	269,024
Gross income	$3,192,586	$ 5,585,120	$ 6,095,191	$ 4,763,292	$ 3,922,195
Interest on funded debt—subsidiaries	..........†	..........†	2,150,673	2,220,156	1,436,239
General interest—subsidiaries	..........†	..........†	32,167	42,955	40,081
Amortized debt discount and expense—subsidiaries	..........†	..........†	142,737	142,742	79,610
Interest during construction—subsidiaries	cr. 38,501	cr. 67,830	cr. 41,271	cr. 17,236	cr. 15,001
Preferred dividends—subsidiaries	328,286	512,789	630,114	501,662‡	492,527‡
Minority interest in subsidiaries	70,864	166,384	69,141	53,714	41,449
Balance applicable to ATU Co.	$2,831,937	$ 4,973,777	$ 3,111,630	$ 1,819,299‡	$ 1,847,290‡
Interest on funded debt	1,427,870†	2,878,580†	1,484,039	1,587,938	1,587,938
General interest	28,913†	6,242†	20,469	64,647	136,031
Amortized debt discount and expense	130,454†	210,791†	127,876	153,411	153,411
Net income	$1,244,698	$ 1,878,163	$ 1,479,246	$ 13,305‡	$ 30,090‡[d]
Times over-all charges earned	1.67	1.53	1.33	1.00	0.99
Prior preferred dividends	$ 283,364	$ 285,878 }	$ 667,894		
Preferred dividends	75,833	300,000 }			
Times over-all charges and prior pfd. divs. earned	1.40	1.31	1.16	0.86	0.85
Common dividends (cash)	$ 300,081				
Common dividends (stock)§	253,822	$ 505,277	$ 501,939		
Surplus for year‖	$ 331,598	$ 787,007	$ 309,413		

* Pro forma consolidated income account after giving effect to the elimination of the income accounts of Standard Telephone Company and subsidiaries and Central Telephone Company and subsidiaries, and elimination of all investments in Standard Telephone Company, Central Telephone Company, and Indiana Central Telephone Company, with the exception of $175,000 principal amount of first lien collateral 5½% gold bonds of latter company, such companies having been placed in receivership or bankruptcy since December 31, 1932.

† Interest charges on funded debt and general interest and amortization charges of subsidiaries and parent company are combined in the years 1929 and 1930 as separate figures are not available.

‡ No provision has been made above for cumulative preferred dividends of certain subsidiaries in arrears for the year ended December 31, 1932, amounting to $38,954.

§ Represented by no-par shares: 1931, 50,193.868; 1930, 50,527.729; 1929, 16,253.23.

‖ Before surplus adjustments.

[d] Deficit.

Compiled from Moody's *Public Utilities*, 1933.

funded debt of the top company had decreased to a marked extent because of the fixed interest and dividend charges on publicly held securities of the subsidiary corporations. The operating companies were finding increasing difficulty in financing their own capital requirements, with the result that it became even harder to make their earnings available to ATU.

By May 1, 1933, financial difficulties had brought three subsidiaries into the hands of the courts. On April 19, Mr. Ward and Mr. Wardall were appointed receivers for Standard Telephone Company also. Two weeks later interest on its first lien collateral trust 5½% gold bonds was defaulted. ATU's interest in the Standard Telephone Company was represented by all the common stock, nearly 85% of the preferred, and unsecured notes in the amount of $1,611,651 of a total of $1,915,351. On April 29, 1933, Central Telephone Company was adjudicated a voluntary bankrupt, and on May 1, 1933, the Indiana Central Telephone Company, a wholly owned subsidiary of Central Telephone Company, entered receivership under the same receivers as were serving for ATU and the Standard Telephone Company.

Soon after receivers were appointed for ATU, a reorganization committee was formed. Under date of June 20, 1933, it presented a plan and agreement whereby holders of notes, debentures, and stock of the company might participate by deposit of their securities. Excerpts from the plan follow:

BASIS OF PLAN

. . . it is obvious that the earnings for the immediate future are not sufficient to support any substantial amount of fixed interest charges, and . . . it would be contrary to the interest of every security holder to provide for the issuance by the new company to existing general creditors of cumulative income bonds or preferred stock upon which, it is fair to assume, large arrears of interest or dividends would be accumulated during the next few years. The committee . . . would not be warranted in formulating any plan which was based upon a conjecture as to when and how rapidly recovery of the earning power of the ATU group might be expected to take place. They have endeavored rather to formulate a plan which at any earnings level would accord just treatment to all classes of securities and give due and proper recognition to their relative rank and priorities.

. . . . . .

The underlying purposes and effect of the Plan are

First: To give full recognition to the paramount rights of the noteholders, debenture holders, and other creditors.

Second: With respect to the holders of the 6% secured gold notes, to provide an instrumentality which will enable them in effect to retain the full benefits of the security which they now have and at the same time to assure them, in the alternative, equal participation with other creditors in the assets and earnings of the company. . . .

Third: To provide a corporate structure which, through the elimination of all fixed charges, obviates any possibility of further reorganization should earnings further decline.

Fourth: To provide a method of raising, through the purchase rights afforded to the existing preferred stockholders, a maximum of $4,868,550 additional cash capital which the new company can advantageously use, . . .

Fifth: To enable all stockholders to regain an interest in the enterprise, if . . . the earnings of the group reach a point at which the common stock of the new company received by present creditors has a value comparable to the existing debt, and upon a basis which takes due account of the present junior rank of the stockholders and of the relative rights and priorities of the different classes of stock.

. . . . . .

THE NEW COMPANY AND THE NEW SUBSIDIARY

Two new corporations (one hereinafter called the "new company" and the other hereinafter called the "new subsidiary") will be organized. . . . All of the common stock of the new subsidiary will be owned by the new company. The new company will acquire all of the assets of ATU, with such exceptions only as the reorganization committee may approve and except also the $6 preferred stocks of Interstate Telephone Company and Southwestern Associated Telephone Company and the 6% preferred stock of Michigan Associated Telephone Company, which are now pledged as security for ATU's 6% secured gold notes. These preferred stocks will be acquired and held by the new subsidiary. The new subsidiary will also own up to 82,175 shares of the common stock of the new company.

DESCRIPTION OF SECURITIES OF THE NEW COMPANY

The authorized capital stock of the new company will consist of $3 convertible preferred stock (hereinafter called the "new preferred") and common stock (hereinafter called the "new common"), in either case without par value or with such par value as the reorganization committee shall determine. The new company will also authorize the issuance of the below described stock warrants and purchase rights.

1. The new preferred will be authorized in the amount of 100,000 shares . . . preferred both as to assets and dividends. . . . Such dividends shall be cumulative . . . will be redeemable as a whole or in part on any dividend date at $50 per share, plus accumulated and unpaid dividends. The holders of the new preferred will be entitled to receive on liquidation or dissolution $50 per share, plus accumulated and unpaid dividends. . . .

The new preferred will be convertible, at the holder's option, at any time prior to the tenth day next preceding the date fixed for the redemption thereof, into new common on a share for share basis, . . .

The holders of the new preferred shall be entitled to one vote for each share.

2. New common will be authorized in the amount of 1,100,000 shares. . . . Up to approximately 452,290 shares will be reserved for the exercise of the purchase rights . . . for the conversion of the new preferred and for the exercise of the stock warrants. . . .

. . . without the affirmative vote or written consent of the holders of at least 60% in amount of the outstanding new common, the new company shall not

a. Issue . . . or guarantee any obligation . . . for capital purposes . . . in an amount . . . exceeding an aggregate of $500,000 at any one time outstanding.

b. Mortgage or pledge any of its property, except by way of purchase money liens or pledge of current assets for current loans for other than capital purposes or expenditures.

c. Dispose . . . of the property and business of the new company as a whole or substantially as a whole.

d. Authorize the creation . . . of any new class of stock ranking as to dividends or assets prior to the new common, or increase the authorized number of shares of new preferred.

The holders of new common shall be entitled to one vote for each share.

3. Purchase rights . . . will be authorized for issue to the extent required for distribution to holders of preferred stock of ATU participating in the plan. Purchase rights will grant the holders thereof the right to purchase units consisting of one share of new preferred and one share of new common, at the price of $50 per unit, at any time on or before November 1, 1934 . . .

4. Stock warrants for new common . . . will be authorized for issue to the extent required for distribution to stockholders of ATU participating in the plan. Stock warrants will grant the holders thereof the right to purchase shares of new common at any time on or before November 1, 1948, at the price of $50 per share. . . .

DESCRIPTION OF SECURITIES OF THE NEW SUBSIDIARY

The authorized capital stock of the new subsidiary will consist of $6 preferred stock (hereinafter called "collateral preferred") and 100 shares of common stock, in either case without par value or with such par value as the reorganization committee shall determine.

1. The collateral preferred will be authorized in the amount of 38,580 shares and will be issued only to holders of the 6% secured gold notes of ATU. . . . [It] will be preferred both as to assets and dividends. The holders of the collateral preferred shall be entitled to receive preferential dividends at the rate of $6 per share per annum

payable quarterly. . . . Such dividends shall be cumulative from November 1, 1933. The collateral preferred will be redeemable as a whole or in part at any time, upon 20 days' notice, at $106.50 per share, plus accumulated and unpaid dividends. The holders of the collateral preferred will be entitled to receive on liquidation or dissolution $106.50 per share, plus accumulated and unpaid dividends. . . .

The new subsidiary will own 2.13 shares of new common in respect of each share of collateral preferred issued under the plan, and shares of collateral preferred will be convertible, at the holder's option, at any time prior to the tenth day next preceding the date fixed for the redemption thereof, into new common at the rate of 2.13 shares of new common for each share of collateral preferred. . . .

The certificate of incorporation of the new subsidiary shall, among other things, provide: that the new subsidiary shall not purchase or redeem its own stock of any class while dividends on the collateral preferred are in arrears or until dividends for the then current period on the collateral preferred are provided for; that, until all the collateral preferred shall have been redeemed or otherwise retired, the new subsidiary shall not sell . . . any of the new common owned by it (except in exchange for collateral preferred as aforesaid), and shall not pay any dividends . . . on any class of stock other than the collateral preferred; that shares of collateral preferred redeemed, purchased, or otherwise acquired by the new subsidiary shall be canceled and shall not be reissued; that the affirmative vote or written consent of the holders of at least 75% in amount of the collateral preferred at the time outstanding will be required to authorize:

a. Mortgages or pledges, without exception.

b. The sale or other disposition of any of the shares of preferred stock of Interstate Telephone Company, Southwestern Associated Telephone Company, or Michigan Associated Telephone Company for any consideration other than cash, or at less than $100 per share.

c. The incurrence of any debt or obligation except for necessary current expenses.

d. The creation of any new class of stock whatsoever.

e. Any increase in the authorized number of shares of any class except the common stock.

f. Any amendment, alteration, change, or repeal of any of the above outlined provisions.

And that the entire net proceeds of any sale or disposition of any of said shares of preferred stock of Interstate Telephone Company, Southwestern Associated Telephone Company, or Michigan Associated Telephone Company shall be applied by the new subsidiary . . . to the purchase and/or redemption of the collateral preferred.

Except as hereinabove expressly provided . . . the collateral preferred shall have no voting powers.

The shares of new common at any time held by the new subsidiary shall not be voted by it at any meeting of the new company, but any holder of collateral preferred shall be entitled, upon request, to receive from the new subsidiary a proxy entitling him to vote 2.13 shares of

new common in respect of each share of collateral preferred held by him.

2. The common stock of the new subsidiary will be authorized in the amount of 100 shares. . . .

All corporate expenses of the new subsidiary will be borne by the new company. The business of the new subsidiary will be restricted to acquiring, holding and disposing of, the preferred stocks of Interstate Telephone Company, Southwestern Associated Telephone Company, and Michigan Associated Telephone Company and new common, all as contemplated by the plan.

DISTRIBUTION OF NEW SECURITIES

Holders of the above-mentioned notes, debentures, and/or stocks of ATU, who become parties to the plan, will be entitled, upon its consummation and upon surrender of their certificates of deposit in form transferable by delivery, to receive securities of the new company and/or the new subsidiary (herein collectively referred to as the "new securities"), upon the following bases:

1. *Holders of 6% secured gold notes* of ATU will be entitled to receive, for each $1,000 principal amount of deposited notes, 10 shares of collateral preferred.[1]

2. *Holders of 15-year gold debentures* of ATU will be entitled to receive one share of new common for each $50 of indebtedness represented by deposited debentures, including the interest accrued thereon at the respective coupon rates up to April 1, 1933, and at the rate of 6% per annum thereafter up to November 1, 1933, that is to say, at the following rates:

a. Series A 6% convertible: 20.8 shares of new common for each $1,000 principal amount of deposited debentures.

b. Series B 5%: 21.2 shares of new common for each $1,000 principal amount of deposited debentures.

c. Series C 5½% convertible: 21.158 shares of new common for each $1,000 principal amount of deposited debentures.

3. *Holders of cumulative prior preferred stock* of ATU, of both series, will be entitled for each share of deposited stock, to receive

a. Stock warrants representing the right to purchase two shares of new common; and

b. Purchase rights representing the right to purchase one unit consisting of one share of new preferred and one share of new common.

4. *Holders of $6 convertible preferred stock* of ATU will be entitled, for each share of deposited stock, to receive

[1] These 10 shares of collateral preferred are, at the holder's option, convertible into 21.3 shares of new common, so that, by such conversion, holders of 6% secured notes may receive 1 share of new common for each $50 of indebtedness represented by said notes, including the interest accrued thereon at 6% per annum up to November 1, 1933.

a. Stock warrants representing the right to purchase 1 share of new common; and

b. Purchase rights representing the right to purchase one-half of a unit consisting of one share of new preferred and one share of new common.

5. *Holders of common stock* of ATU will be entitled to receive stock warrants representing the right to purchase 1 share of new common for every 10 shares of common stock deposited.

All other general creditors of ATU, whose claims shall be established by a court of competent jurisdiction or otherwise to the satisfaction of the reorganization committee, will be entitled, upon consummation of the plan, to receive new common upon the same basis as the holders of the 15-year gold debentures of ATU, upon assignment of their claims in form satisfactory to the reorganization committee. . . .

. . . . . .

In Exhibit 3 is given a schedule of participation in the distribution of new securities of the new company.

EXHIBIT 3
ASSOCIATED TELEPHONE UTILITIES COMPANY
SCHEDULE OF PARTICIPATION IN DISTRIBUTION OF NEW SECURITIES BY HOLDERS OF EXISTING SECURITIES PARTICIPATING IN THE PLAN

Existing securities		New securities				
Issue	Presently outstanding	Collateral preferred of new subsidiary	New common	Stock warrants to buy new common	Purchase rights to buy units of New common	Purchase rights to buy units of New preferred
6% Secured Notes	$ 3,858,000	38,580 sh.	82,175 sh.†			
Accrued Interest*	250,770					
Debentures, A-6s	2,082,100	....	41,642			
Accrued Interest*	83,284	....	1,665			
Debentures, B-5s	1,750,000	....	35,000			
Accrued Interest*	105,000	....	2,100			
Debentures, C-5½s	21,007,500	....	420,150			
Accrued Interest*	1,216,684	....	24,333			
Unfunded Indebtedness	457,311‡	....	9,146			
Prior Preferred Stock						
$7 Series	45,692 sh.	....	....	91,384 sh.	45,692 sh.	45,692 sh.
$6 Series	27,921	....	....	55,842	27,921	27,921
Convertible Stock	47,517	....	....	47,517	23,758	23,758
Common Stock§	622,743 527					
Scrip	5,304.073					
	628,047.600 sh.	....	....	62,804		
Totals	....	38,580 sh.	616,211 sh.	257,547 sh.	97,371 sh.	97,371 sh.

* At coupon rate to April 1, 1933, and at 6% thereafter to November 1, 1933.
† To be held by new subsidiary.
‡ This is the net amount (including interest to November 1, 1933) which the receivers estimate will result, after deducting from the unfunded indebtedness, as shown in ATU's balance sheet, certain offsets which the receivers are advised can be effected.
§ Common stock (or scrip for common stock) will not be accepted for deposit, except in amounts aggregating 10 or more full shares.
Source: Plan and Agreement submitted by the Reorganization Committee, June 20, 1933.

1. Analyze the plan for reorganizing the Associated Telephone Utilities Company to determine how fully it met the stated objectives of the reorganization committee.

2. Answer the objection that the secured noteholders were too favorably treated under the plan.

3. Explain the purpose and advantages of the purchase rights and stock warrants.

4. What advantages that could not be had from a single new corporation were obtained through the organization of both the *new company* and the *new subsidiary*?

B

Deposits of securities, as of July 7, 1934, under the plan of reorganization for ATU as published June 20, 1933, were reported by the bondholders' protective committee as follows:

Security	Total amount outstanding	Total amount deposited	Percentage deposited
6% Secured Gold Notes.....	$ 3,858,000	$ 2,889,000	74.88
Fifteen-Year Gold Debentures....	$24,839,600	$15,431,300	62.12
Cumulative Prior Preferred Stock:			
$7 Series....................	45,692 sh.	28,053 sh.	61.39
$6 Series....................	27,921 sh.	15,537 sh.	55.64
6% Convertible Preferred Stock..	47,517 sh.	24,810 sh.	52.21
Common Stock.................	628,047.6 sh.	239,294 sh.	38.10

In considering this slow response of holders of ATU securities, it should be noted that the reorganization committee did not lead an aggressive campaign to get quick acceptance of its plan. Contrary to the usual practice in such cases, no fees were given to bankers and dealers for their efforts in obtaining deposits.

ATU was one of the first companies to petition for reorganization under Sec. 77*B* of the amended National Bankruptcy Act. In a letter of July 12, 1934, the committee explained to all holders of ATU securities this change in procedure, in part as follows:

Shortly after the approval by the President of the United States of the new Sec. 77*B* of the National Bankruptcy Act, providing a new procedure for the reorganization of corporations, Associated Telephone Utilities Company filed a petition for reorganization under

the new law in the United States District Court for the Southern District of New York; and, on June 8, 1934, the Court approved the petition . . . and temporarily appointed William J. Wardall as trustee of the Company's property. . . .

. . . .

Under the provisions of Sec. 77*B*, a plan of reorganization which has been accepted by the holders of two-thirds in amount of any class or classes of creditors and/or by the holders of a majority in amount of any class or classes of stockholders, and which, after hearing upon due notice, has been confirmed by the Court, will be binding upon all the creditors and stockholders of such class or classes, all of whom will be required to accept new securities as provided in such plan of reorganization.

The action of the company in filing its petition for reorganization under Sec. 77*B* was taken with the approval of the reorganization committee who intend, at the earliest appropriate moment, to propose and file in the reorganization proceedings the plan and agreement of reorganization dated as of June 20, 1933. . . .

. . . .

At the present time, the most important factor in effectuating the reorganization procedure prescribed by Sec. 77*B* is cooperation by those security holders who have not yet deposited their securities. . . . Under these conditions, the reorganization committee are not yet prepared to apply to the Court for final confirmation of the plan.

The reorganization committee therefore strongly recommend to all security holders (especially holders of debentures and of common stock) who have not yet deposited their securities under the plan and agreement that they deposit the same promptly, so that, at the earliest possible date, the reorganization committee may be in a position to apply to the Court for confirmation of the plan and to consummate the reorganization.

. . . .

As of October 13, 1934, it was reported that the following deposits of securities had then been made:

Security	Total amount outstanding	Total amount deposited	Percentage deposited
6% Secured Gold Notes	$ 3,858,000	$ 3,121,000	80.89
Fifteen-Year Gold Debentures	$ 24,839,600	$17,879,100	71.97
Cumulative Prior Preferred Stock:			
$7 Series	45,692 sh.	31,641 sh.	69.24
$6 Series	27,921 sh.	18,931 sh.	67 80
$6 Convertible Preferred Stock	47,517 sh.	28,226 sh.	59.40
Common Stock	628,047.6 sh.	327,112 sh.	52 08

How did the petition under the new Sec. 77*B* change the problem for the security holders who had not yet deposited?

C

The Standard Telephone Company, an intermediate holding company in the ATU group, had financed the control of its subsidiaries largely through the issue of $4,400,000 collateral trust bonds, $845,000 convertible debentures, and 17,735 shares of preferred stock. A consolidated balance sheet of the Standard

EXHIBIT 4
STANDARD TELEPHONE COMPANY* (DELAWARE)
CONSOLIDATED BALANCE SHEET, AS OF DECEMBER 31

Item	1929	1930	1931	1932
ASSETS				
Property and Franchises	$7,604,442	$10,512,678	$8,968,529†	$8,777,993†
Other Investments	11,867	6,536	....	1,540
Current Assets:				
Cash and Working Fund	139,090	190,714	90,306	115,633
Cash and Accounts Receivable (Net)	87,169	74,518	76,811	74,556
Materials and Supplies	104,642	218,175	194,586	183,867
Interest Deposits	....	....	2,730	
Due from Affiliated Companies	150,344	173,981	44,723	14,961
Special Deposits	33,901	23,886	115,003	31,216
Prepaid Items	12,861	16,686	20,126	13,076
Deferred Charges	4,067	58,763	31,731	17,428
Debt Discount and Expense	167,019	216,274	169,137	157,522
Total Assets	$8,315,402	$11,492,211	$9,713,682	$9,387,792
LIABILITIES				
Preferred Stock‡	$1,717,860	$ 1,722,860	$1,729,360	$1,736,360
Common Stock‡	200,000	200,000	200,000	200,000
Subsidiary Preferred Stock	28,600	21,900		
Minority Interest	9,912	4,570		
Funded Debt	5,245,000	6,454,000	5,763,000	5,505,500
Due Affiliated Companies	390,172	1,536,828	1,033,884	1,083,111
Current and Accrued Liabilities:				
Accounts Payable	80,492	102,768	41,633	37,889
Accrued Interest		60,873	50,060	47,175
Accrued Taxes (Including Federal)	145,579	120,115	40,979	36,405
Accrued Preferred Dividends		20,581	20,609	
Other Current Liabilities		12,524	23,874	12,966
Depreciation Reserve	326,794	1,047,443	639,126	638,179
Other Reserves	9,902	21,659	4,809	8,669
Deferred Liabilities	1,265	....	3,829	4,335
Capital Surplus	246,890	246,890	246,890	246,890
Earned Surplus	87,063[d]	80,803[d]	84,370[d]	169,687§[d]
Total Liabilities	$8,315,402	$11,492,211	$9,713,682	$9,387,792

* Incorporated October 26, 1928.
† Includes $1,750,652 in 1932 and $1,660,205 in 1931, the amounts by which consolidated book value of property exceeds the combined book value of subsidiary companies' properties.
‡ Represented by no-par shares: preferred, 17,735 in 1932, 17,665 in 1931, and 17,600 in 1930; common, 100,000.
§ Cumulative dividends on preferred stock in arrears at December 31, 1932, and not provided for, amounted to $118,972.
[d] Deficit.
Compiled from Moody's *Public Utilities*.

Telephone Company for the four years ending with 1932 is given in Exhibit 4, and a consolidated income statement in Exhibit 5.

EXHIBIT 5
STANDARD TELEPHONE COMPANY (DELAWARE)
CONSOLIDATED INCOME ACCOUNT,
YEARS ENDED DECEMBER 31

Item	1929	1930	1931	1932
Operating revenue	$1,447,961	$1,556,433	$1,321,147	$1,133,579
Operating expense	914,420	545,464	483,417	459,992
Maintenance		255,447	193,863	166,930
Taxes (state and local)		148,928	79,787	76,486
Depreciation	108,704	109,209	88,266	123,240
Net operating revenue	424,837	497,385	475,814	306,931
Operating ratio	70.66%	68 04%	63.98%	72.92%
Other income	$ 13,929	$ 58,159	$ 4,232	$ 6,905
Total income	438,766	555,544	480,046	313,836
Interest on funded debt	292,967	365,890	337,506	318,520
Other interest	14,698	54,328	52,300	65,812
Amortized discount and expenses	13,106	17,493	15,075	14,264
Interest charged to construction	.....	cr. 7,570	cr. 2,292	cr. 768
Balance	117,995	125,403	77,457	83,993[d]
Subsidiaries' preferred dividend	12,761	1,775		
Minority interest	1,459	1,201		
Times over-all charges earned	....	1.28	1.19	0.78
Net income	$ 103,775	$ 122,427	$ 77,457	$ 83,993[d]
Preferred dividends	121,287	123,187	123,473	10,341
Times over-all charges and preferred dividends earned	....	0.99	0.91	0.60
Deficit*	$ 17,512	$ 760	$ 46,016	$ 94,334

* Before net surplus adjustments: 1930, deficit of $7,022; 1931, credit of $42,448; 1932, credit of $9,017.
[d] Deficit.
Compiled from Moody's *Public Utilities.*

An examination of the balance sheet for the Standard Telephone Company alone, as of December 31, 1932, shows that the largest items among the assets were investment in subsidiaries' common stock, $4,248,895; in subsidiaries' bonds, $2,238,737; and due from affiliated companies, $1,163,280. Total assets were $7,808,432. Of the current liabilities, notes and accounts due affiliated companies were $1,097,259. The capital surplus

of $246,890 was offset by a deficit of $298,472. The income account for the year ended December 31, 1932, showed a net operating revenue of $262,599, and a net loss of $83,680. After preferred dividends of $10,341, the deficit for the year was $94,021.

The management of the company became convinced early in 1933 that default in interest due May 1 was unavoidable. The court granted a petition for receivership and on April 19, 1933, appointed receivers for the company.

A bondholders' protective committee[1] was promptly formed which drew up a protective agreement with the holders of the first lien collateral trust bonds under date of May 1, 1933. Excerpts from the committee's letter to the bondholders follow:

. . . . . .

Because of the lack of sufficient funds the interest due May 1, 1933, on the first lien collateral trust bonds was not paid.

. . . a bondholders' committee has been formed consisting of representatives of houses whose clients hold a large proportion of this bond issue. *This committee has been organized to act solely in the interest of the first lien bondholders.*

. . . The individuals constituting the committee have for some months kept in close touch with the situation and have given consideration to the course of action to be followed in event of default. As the result it has been possible without the usual long delay to formulate and adopt the following plan of reorganization. . . .

. . . . . .

The capitalization of the company and its indebtedness as of April 15, 1933, consisted of the following:

	Outstanding
First lien collateral trust 5½% gold bonds, Series A, due 1943	$3,953,500
10-year 6% convertible gold debentures, due 1938	826,500
Notes and accounts payable covering advancements by parent company	1,044,634
Preferred stock, $7 cumulative	17,735 sh.
Common stock	30,000 sh.

The following shares and amounts of indebtedness included in the above figures are owned by the parent company, Associated Telephone Utilities Company:

10-year 6% convertible gold debentures, due 1938	$ 523,000
Notes and accounts payable covering advance	1,044,634
Preferred stock, $7 cumulative	15,073 sh.
Common stock	30,000 sh.

The first lien collateral gold bonds are secured by the pledge of all of the preferred and common stocks and substantially all bonds

[1] First called the Dodge committee, and later the Beringer committee after the respective chairmen.

and other evidences of indebtedness of . . . subsidiaries (other than certain underlying bonds held by the public, *viz.*, $600,000 bonds of Platte Valley Telephone Company and $88,000 underlying bonds of Iowa State Telephone Company). . . .

Statements of the company and its subsidiaries . . . show that for the year ended December 31, 1932, consolidated net income for the properties in the system after all operating expenses, maintenances, and taxes, other than Federal income taxes, but before depreciation, was $433,903.06. After deducting a provision for depreciation which the present management of the company is convinced is necessary for the proper protection of the properties, the balance available for interest charges, Federal income taxes, etc., was $241,103.06; annual interest charge on funded debt of subsidiaries in the hands of the public, together with interest charges on the first lien collateral trust bonds, amounted to $258,722.50. In addition the annual interest charges on unsecured debentures and floating debt amounted to $111,548.63, thus making a total fixed charge of $370,271.13, for which there was only $241,103.06 available from earnings, assuming all this could be made available in cash to apply toward fixed charges.

For 1933 the company has made careful budget forecasts of operations, and naturally with the drastic decline in the number of telephone stations which has occurred during the past 18 months, this budget indicates a substantial reduction in both gross and net earnings of the company's subsidiaries. The actual results of operations for the first quarter of 1933, compared with the first quarter of 1932, together with the number of stations in service at the end of each of these quarters, is given below, the same basis of depreciation above mentioned being applied in both cases:

Item	March 31, 1932	March 31, 1933
Gross Revenues...	$295,866.33	$246,668.34
Operating Expenses, Maintenance and Taxes (except Federal Income Taxes)...	179,347.94	149,959.63
Net Earnings before Depreciation........	$116,518.39	$ 96,708.71
Provision for Depreciation.	48,200 00	48,200.00
Net Earnings after Depreciation...... ...	$ 68,318.39	$ 48,508.71
Interest on Prior Lien and First Lien Bonds	64,680.63	64,680 63
Number of Stations......	42,112	35,986

The executive control of the company passed into the hands of the present management on April 1, 1932, since which time substantial economies in operation have been effected and many constructive steps taken in the corporate relations between subsidiaries, also between subsidiaries and others. Your committee feels that the present operation of the properties is efficient, that the management of the

properties is being conducted at cost and economically. However, after giving careful consideration to the present earnings of the company and the estimates of operation for 1933, which show a further material decline in business, the committee has come to the conclusion that it will be impossible for the company to carry its present interest burden or to exist under its present capitalization.

The committee in view of this situation has formulated a plan of reorganization which it believes to be not only a practical one, but one which gives to the present holders of first lien collateral trust bonds the fullest protection for their investment in the company.

The plan of reorganization adopted by the committee contemplates the sale, at an early date, of the collateral securing the first lien bonds, the acquisition of such collateral by a new corporation to be organized for this purpose, and the distribution to the depositing bondholders for each $1,000 bond deposited, of the following securities of the new corporation, to wit:

a. $500 principal amount of new first lien collateral trust 5% bonds.
b. $250 par value 6% preferred stock.
c. 20 shares common stock of such stated or par value as the committee may determine, to be represented by voting trust certificates. A proportionate amount of the new securities is to be distributed for each $500 bond deposited.

The common stock reserved for bondholders represents at least 66⅔% of the entire issue of such stock, 33⅓% being reserved for any one or more of the following purposes:

1. For the acquisition of debentures and other evidences of debt of Standard Telephone Company owned by the parent company and others.
2. Such financing as may be necessary to place the committee in position to consummate the plan.
3. To provide satisfactory management for the new company.

The common stock is to be placed in a voting trust agreement for 10 years. A majority of the voting trustees are to be chosen by the bondholders' committee.

The new company is to have the following capitalization:

Item	Authorized	Reserved for use under plan of reorganization
First Lien Collateral Trust 20-year Gold Bonds	*	$ 2,276,750
Preferred Stock, $25 Par, 6%	50,000 sh.†	39,535 sh.
Common Stock	118,605 sh.	118,605 sh.

* Restricted by terms of indenture.
† The preferred stock shall be noncumulative, but the charter shall contain provisions to the effect that no dividends shall be declared or paid on the common stock unless and until dividends shall have been paid at the rate of 6 % per annum on all of the preferred stock issued and outstanding from the issuance thereof.

Of the $2,276,750 bonds reserved under the plan, $1,976,750 are reserved for delivery to assenting bondholders (assuming 100% consent), and $300,000 are reserved for sale, but only if and to the extent required to provide funds for the acquisition of the collateral securing the present Standard Telephone Company bonds, and to provide working capital for the new company. . . . Such indenture will contain carefully drawn restrictions to prevent substitutions and sales of collateral except such as are definitely in the interest of holders of the new bonds.

In order to facilitate the consummation of the plan of reorganization and insure for the bondholders a substantial participation in those assets of Standard Telephone Company, including current assets, which are not pledged under the indenture securing the first lien bonds, the committee has tentatively arranged with the receivers of the parent company, subject to the consummation of the plan as now constituted, for the acquisition from the receivers of the parent company of all the debentures, notes, and other evidences of indebtedness of Standard Telephone Company owned by the parent company, tabulated above, amounting to approximately $1,567,000 consisting of $523,000 ten-year 6% debentures (over 63% of the amount outstanding) and approximately $1,044,634 of notes and accounts, in consideration of the delivery to them of a portion of the reserved common stock of the new company. Such indebtedness to be so acquired represents over 80% of the total indebtedness of Standard Telephone Company other than its prior lien and first lien bonds. The committee shall have the right to make similar arrangements with various holders of the remaining indebtedness. . . .

. . . . . .

Shortly after the Dodge committee was formed, another committee, known as the Walsh committee, solicited deposits of bonds on the strength of a severe criticism of the Dodge plan. The position of the Walsh committee was summed up in a letter of November 23, 1933, in which the Dodge plan was held to be grossly unfair to the bondholders, on the ground that, by allowing the committee the discretion to use up to 33⅓% of the common stock of the company to acquire the interests of the junior securities, it would sacrifice one-half of the principal and divide pledged assets with the holders of junior securities. The Walsh committee further outlined in general terms a plan that would give to the bondholders new bonds par for par, possibly with a lower interest rate, and all of a new issue of common stock but without the voting trust arrangement of the Dodge plan.

Following the example of ATU, petitions were filed before the proper Federal court by both the Standard Telephone Company and the Walsh committee for reorganization under Sec. 77*B* of

the amended National Bankruptcy Act. The two petitions were consolidated by the court, an order was entered placing the company's affairs under the jurisdiction of the court, and a temporary trustee was appointed. At the time these petitions were presented, the Walsh committee was said to control about \$1,100,000 of these bonds and the Beringer committee about \$900,000. No plan of reorganization was presented to the court.

Compare the reorganization plan proposed for Standard Telephone Company with that prepared for ATU, with particular reference to the question of how far the differences in the treatment of the security holders in the two companies appear justified by the financial data presented.

7. SUPERIOR THEATER CORPORATION

REORGANIZATION INVOLVING FIRST MORTGAGE LEASEHOLD BONDS

The Superior Theater Corporation defaulted on the interest and principal payments due March 1, 1933, on its issue of first mortgage leasehold bonds. The receivers, who were appointed within the week, chose to retain the same operating management pending a thorough examination of the company's position with a view to reorganization. It was apparent that no quick and simple solution would be reached. The complex business relationships which had developed during the short life of the company added to the difficulty of formulating a plan that would satisfactorily compose the various interests.

The promotional aspects of the Superior Theater Corporation were essentially the same as in scores of other theater projects launched during the period when important companies in the motion-picture industry were expanding rapidly to gain control of modern theaters in the most favorable locations. Late in 1926 the Empire Films Corporation[1] made a preliminary survey in a large Eastern city with the intention of sponsoring a theater development. Upon hearing of these developments a local realty company, which had been assembling a group of long-term leases in a valuable block in the city, concluded that the possibilities for the greatest return from the site could best be realized by the construction of a modern theater. The layout of the leased parcels made it advantageous to include in the plans a six-story office building with space for specialty stores on the first floor. To promote these plans the realty company, reincorporated as the Superior Theater Corporation, acquired title to the various leasehold estates and proceeded to raise the funds for the building. The location of the proposed buildings with respect to the parcels of land owned by the five lessors is shown in Exhibit 1.

At that point a construction company became interested in the project and actively entered the promotional negotiations. Plans for the buildings were drawn, and conferences were held to arrange for the financing. Two investment banking firms became interested in the venture. The larger one, Downes and Company, Philadelphia, took the lead in pointing the preliminary discussions

[1] Empire Films Corporation was an operating and a holding company engaged in producing and leasing motion pictures. Through a large subsidiary organization it owned, leased, and operated an extensive system of motion-picture theaters.

to a type of financial plan that it would be willing to underwrite. It refused to consider the first suggestion of the Superior Theater Corporation to finance the entire cost of the building through an issue of mortgage bonds and insisted that it would have no part in the proposed financing unless provision was made for a substantial equity. It also insisted that the new corporation should operate under a sublease to an established and recognized leader in the motion-picture field rather than under an operating agreement for which a local company alone was responsible.

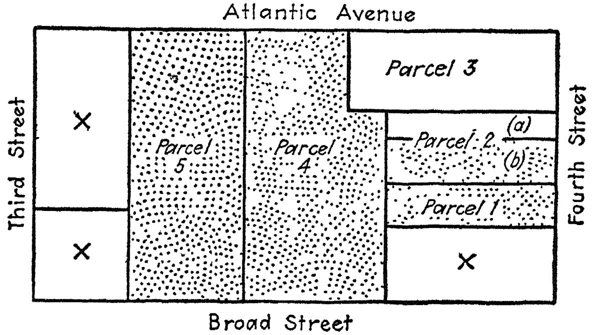

EXHIBIT 1.—Superior Theater Corporation. Diagram showing location of proposed theater building.
Theater building would occupy shaded portion.
Office building would cover Parcel 3 and Portion (a) of Parcel 2.
Parcels X were not under lease.

Accordingly, financial arrangements were made with the two investment banks which agreed to buy $1,800,000 serial first mortgage leasehold bonds provided the company would furnish a certified statement by an appraisal company that the value of the leaseholds, together with a theater and office building erected according to specifications, would amount to at least $2,500,000. A completion bond was to be furnished by the construction company and the net proceeds of the leasehold bonds were to be deposited with the trustee who was to release the funds on certificate as the construction progressed. With relatively small annual maturities in the earlier years, larger amounts became due in succeeding years and a final maturity of $900,000 on March 1, 1943. These serial bonds were to be ratably secured by a first mortgage leasehold trust deed covering the five leaseholds mentioned above. The mortgage further included all the buildings and improvements erected or to be erected thereon as well as the equipment then owned or subsequently acquired for use in

their operation. At the time the bonds were issued, the prospectus carried the appraisal value of the leasehold estates at $375,000 after giving effect to the buildings to be constructed and equipped.

In accordance with the requirement imposed by Downes and Company, simultaneously with the execution of the first mortgage leasehold trust deed, all the foregoing property was subleased for 15 years from March 1, 1928, to Empire Films Corporation. All the shares of no-par common stock of the Superior Theater Corporation were held by Empire Films Corporation. The descriptive circular for the leasehold bonds directed attention to the large and growing net earnings of the parent company which had acquired the lease. It was pointed out that inasmuch as annual rentals were operating charges they came before the payment of interest on the unsecured funded debt of the parent company. The annual rental under the lease contract was sufficient to pay (*a*) all ground rents under the underlying leases; (*b*) all taxes, assessments, and other charges imposed upon the demised premises; and (*c*) all principal and interest payments on the bonds secured by the leasehold mortgage, as they matured. The tenant was further obligated to keep the property adequately insured and to pay all operating and maintenance expenses of all buildings on the premises. The schedule of annual ground rents payable during the life of the bond issue was: for 1928, $115,000; 1929–1935, $130,200; 1936–1941, $135,000; 1942–1943, $140,500. All rights of the Superior Theater Corporation under this sublease to its holding company were also mortgaged along with the leasehold estates as security for its serial bonds.

Later in 1928 Empire Films Corporation subleased the property of the Superior Theater Corporation to Eastern Theaters Corporation for a period ending February, 1932. When receivers for the latter company were appointed in March, 1933, Eastern Theaters Corporation was still in possession as a holdover tenant, although the agreement had not been renewed after its expiration in February, 1932. By the middle of 1932, following 18 months of rapidly declining gross and net earnings, it became clear that the terms of the underlying leases to the Superior Theater Corporation would require redrafting because of financial distress of the lessees. After careful review of the facts, all the ground owners agreed to reductions and deferments of about 25% of the annual rental for 1932.

The collapse of the Empire Films group was precipitated by the appointment of temporary receivers for the top holding company in February, 1933. Ancillary receiverships for many of its subsidiaries followed immediately. In April, 1933, Empire Films Corporation was adjudicated a bankrupt. The week before Superior Theater Corporation entered receivership, Eastern Theaters Corporation filed a voluntary petition in bankruptcy in the United States District Court. At that time Eastern Theaters Corporation was indebted to Superior Theater Corporation in the sum of $1,195,810.75. Since the receiver in bankruptcy of Eastern Theaters Corporation was in possession of the properties of Superior Theater Corporation as a subtenant, he was permitted by the receivers of the latter company to continue in possession and operation. After election of a trustee in bankruptcy for Eastern Theaters Corporation in April, 1933, he continued in possession of the Superior Theater Corporation until April 30, 1933, when he gave notice that he disaffirmed the lease. The receivers for the Superior Theater Corporation thereupon took over active direction of the property and notified the land owners that they would not assume existing leases but would continue to operate the property and would pay 75% of net operating profit as rental until advised that such arrangement was unsatisfactory. The report of the receivers listed the following assets and liabilities of the Superior Theater Corporation as of March 31, 1933:

Assets		Liabilities	
Accounts Receivable (Proof of claim against Eastern Theaters Corporation, bankrupt, has been filed and there is a contingent liability of Empire Films Corporation for substantially all of said amount)	$1,195,810.75	Amounts Owing Other Companies	$1,243,740.54
Buildings, Leases, and Equipment, Less Reserve for Depreciation	2,440,801.10	Accrued Rent	59,217.00
		Accrued Taxes	49,693.00
		Funded Debt	1,610,000.00
		Accrued Interest to February 1, 1933	96,600.00
Total Assets	$3,636,611.85	Total Liabilities	$3,059,250.54

Promptly after the Superior Theater Corporation entered receivership, the two investment houses, which had underwritten its serial leasehold bonds in 1928, formed a protective committee

and invited deposits of the bonds under an agreement issued late in April, 1933. A letter to bondholders early in May stressed the importance of concerted action to protect their rights and to assure continued operation of the property. The losses sustained through four months had convinced the receivers that experienced management was necessary to obtain attractions adapted to the Superior Theater. The recent operating record of the corporation would not warrant keeping the theater open during the dull summer months. In addition to the existing defaults in interest and principal requirement on the bonds, the status of the corporation as of June 1, 1933, included a delinquency in taxes and ground rent despite the substantial reduction in 1932 rentals granted by the lessors. Real estate taxes for 1932 were still in arrears. So far in 1933 only $17,374 had been paid as rental. The receivers had no funds available to be applied to any of the foregoing defaults. They promptly urged upon the ground owners and the bondholders' committee the importance of quick provision of a more permanent tenant in order to avoid losses which would result from an interruption in business.

After comparison of several proposals, the committee and the ground owners agreed upon a five-year lease by the receivers to an operating company of established reputation. The lease called for an annual minimum rental of $46,800, which was more than sufficient to cover taxes and insurance, with additional rentals based upon graduated percentages of annual gross income ranging from 14% of the first $480,000 to 18½% of all over $600,000. Under this new operating lease the arrears in real estate taxes were to be paid by the land owners, and delinquent personal property taxes were to be paid by the bondholders. Of the net earnings under the lease, the ground owners agreed that the leasehold bondholders should get 25%, net earnings being the amount of annual rental after payment of insurance and property taxes. The new tenant started operations July 1, 1933. By May 1, 1934, after full provision for one-half of the 1933 taxes, the new tenant paid $9,015 to the trustee of the bondholders as their share in the division of income.

In return for these concessions in the new operating lease, the ground owners insisted that the bondholders effect such reorganization of the mortgaged property as would make possible the lifting of the receivership and the assumption by a successor corporation of the receivers' position under the operating lease.

By November, 1933, over 50% of the bonds had been deposited, and the committee considered such support substantial enough to take a preliminary step toward reorganization by requiring the trustee to declare all the bonds immediately due and payable. The following plan of reorganization was then formulated and presented to the bondholders. It was the expressed intention of the committee to execute the plan only in case substantially all the bonds were deposited.

SUMMARY OF THE PLAN

1. A new company was to be formed with an authorized capital stock of 3,220 no-par common shares and 15-year first mortgage leasehold 6% income bonds in the principal sum of $804,000. In exchange for each $1,000 of their old bonds, depositing bondholders would receive two shares of common stock and $500 of the new bonds. The new bonds would be secured by a first mortgage on the leaseholds and all other property, except current assets, acquired by the new company. Noncumulative interest at 6% would be payable from the net income after taxes, assessments, insurance, ground rentals, and other operating expenses, but before depreciation. No fixed sinking fund was to be provided, but such net income as exceeded the interest charges was to be used for the retirement of the new bonds by purchase or by call.

2. The commercial properties[1] were to be separated from the theater property with a consequent annual reduction in real estate taxes and insurance cost from a former total, $39,600, to around $25,000.

3. Annual ground rentals were to be reduced from the fixed amounts under the original lease to a maximum annual rental of $81,300 for a period of five years. Taxes and insurance would constitute first charges against these annual rentals, and of the net earnings remaining 75% was to be disbursed to the ground owners and 25% to the new company. At the end of the term of the operating lease, the rentals would revert to the terms of the original underlying leases adjusted with proportional reductions for the separated properties.

The holders of the leasehold bonds faced still another problem with regard to the disposition of claims filed in the various bankruptcy proceedings then pending for companies within the group. When Empire Films Corporation became bankrupt in April, 1933, its trustees gave notice that they would not adopt the sublease of the Superior Theater property. The receivers of the Superior

[1] Provided the whole plan was consummated, the ground owners agreed to a revision of annual rentals based upon the separation of the commercial properties from the theater property. The owners of the parcels of land occupied by the theater were unwilling to negotiate an adjustment unless the theater project was relieved from the expenses, such as ground rents and taxes, on the adjacent parcels.

Theater Corporation thereupon filed in the Empire Film bankruptcy proceedings a proof of claim for $445,904.84, covering alleged obligation under the sublease. This amount was made up of delinquent rentals, $183,525.10; taxes, $59,788.84; and delinquent interest and principal payments on the leasehold mortgage, $202,590.90. In addition, the trustee for the bondholders filed a proof of claim for the full amount of the outstanding bond issue ($1,610,000) and the receivers for the Superior Theater Corporation filed a supplemental proof for the same amount. There was no clear legal opinion[1] as to the extent to which these claims were provable, especially the item for the bonds. There was also filed against Superior Theater Corporation a claim in the sum of $1,243,740.54 by Empire Enterprises, Inc., the validity of which was disputed by the receivers of Superior Theater Corporation and by the bondholders' committee on the ground that the sum represented payments due from the Empire Films Corporation under its sublease, but which had been paid through its subsidiary, Empire Enterprises, Inc.[2] In order to determine the status of all these counterclaims, expensive litigation would be necessary.

As a result of negotiations between receivers of Superior Theater Corporation and trustees in bankruptcy of Empire Films Corporation, the trustees stated their willingness to buy the rights of the former corporation under the sublease, including the claims of the trustee for the leasehold bondholders, for $180,000 and also to cause the release of the foregoing claims against the Superior Theater Corporation. The committee strongly urged that the bondholders agree to the proposed sale of the sublease and the claims under it. This recommendation was based upon the opinion of counsel that there was grave doubt as to whether the claims for the full amount of the bond issue could be proved against Empire Films Corporation. The committee further emphasized that a claim of the bondholders upon a deficiency judgment, should the then pending reorganization be carried through, would entitle them to much the greater part of the

[1] On the question of future rents as provable debts in bankruptcy, see Manhattan Properties, Inc., v. Irving Trust Co., 66 F. (2d) 470 (July 17, 1933); 54 S. Ct. 385 (Feb. 5, 1934).

[2] Empire Enterprises, Inc., another intermediary corporation in the Empire Films group, directed a chain of theater properties of which Eastern Theaters Corporation was one. The transactions on which this claim was based were recorded as receivables on the balance sheet of Empire Enterprises, Inc , and as payables of Superior Theater Corporation (see list of liabilities, p. 388).

$180,000 to be paid to the receivers of the Superior Theater Corporation under the proposed settlement.

After the committee had reached this conclusion, Congress enacted the amendments to the National Bankruptcy Act relating to corporate reorganizations.[1] These amendments somewhat improved the position of Superior Theater Corporation's claims against Empire Films Corporation, but after due consideration the committee still advised the bondholders not to oppose the proposed sale.

The percentage of recovery on allowed claims against Empire Films Corporation was uncertain. The debentures of that corporation were selling at slightly less than half of their face value. Substantially 87% of the leasehold bonds of the Superior Theater Corporation were on deposit with the committee, with an indication that a further deposit of $120,000 would be made as soon as the liquidator of a bank could get authority for such deposit.

1. Were the financial difficulties which faced the Superior Theater Corporation to any extent caused or rendered less manageable by the method of its original financing? Could the risks incident to the promotion of the theater in 1928 have been avoided by any alternative financial plan?

2. What conclusions can be drawn from this business episode as to the merits of the leasehold mortgage bond in real estate finance? At the time of issue what provision might have been insisted upon which would in this instance have strengthened the position of the leasehold bondholder?

3. Analyze the reorganization plan for the Superior Theater Corporation from the standpoint of (*a*) the legal rights of the various parties in interest, and (*b*) the extent to which the solution was dictated by business expediency.

4. Could it reasonably be argued that the holders of the leasehold mortgage bonds would gain through the proposed sale of their claims under the sublease, including all claims of the trustee of the bondholders of Superior Theater Corporation, for $180,000?

[1] The amendments provide, in substance, that in case of corporate reorganizations under them, claims of landlords for injury resulting from the rejection of an unexpired lease of real estate, or for damage or indemnity under a covenant of such lease shall be provable to an extent not to exceed the rent, without acceleration, for three years next following the date of surrender of the premises, or the date of reentry of the landlord, plus unpaid rent accrued up to the date of surrender or reentry, and also provide, in substance, that in any bankruptcy case claims for future rents shall be provable in an amount not exceeding the rent for the year next succeeding the date of surrender of the premises, plus unpaid rent accrued up to said date.

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